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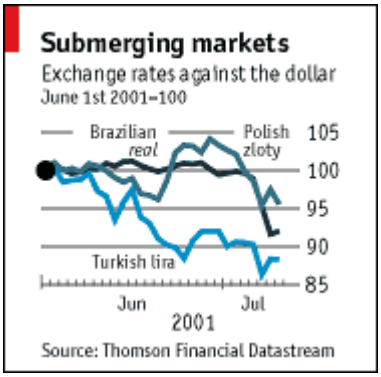
Business this week

Jul 12th 2001
From The Economist print edition

Market jitters

Emerging markets were jittery. Argentina's government bonds fell sharply as investors fretted about a default. The Brazilian *real* hit intra-day lows against the dollar in response. Turkey's lira fell after the country failed to persuade the IMF to release its latest tranche of funds. The Polish zloty and Hungarian forint also weakened. Singapore slipped into recession and its dollar hit an 11-year low against America's.



See article: Gloom over the River Plate

One cause of emerging economies' ills has been the strength of the **dollar,** which this week hit a 16-year high in real trade-weighted terms. The dollar's rise came despite continued signs of weakness in the American economy. Unemployment in June rose to 4.5%.

See article: The greenback's charm

The German Institute for Economic Research published the lowest-yet forecast for **German economic growth** in 2001: a sorry 1%.

See article: No great harm, no good either

A meeting of **G7 finance ministers** concluded on a cheerful note. They stated hopefully that the world economy, particularly America's, would improve soon.

AT&T's plans to break up into four separate units began with the spin-off of its wireless arm. However, the company's low share price prompted **Comcast**, an American cable rival, to offer $44.5 billion for AT&T Broadband, which was to have been spun off later this year. The bid boosted AT&T's shares; but the company said it would not sell.

See article: Loop dreams

Hold the Mayo

John Mayo was forced to resign only two weeks before he was to have become chief executive of **Marconi,** after a profit warning by the beleaguered British telecoms-equipment company. Lord Simpson, the present chief executive, had been expected to become non-executive chairman but will remain in place for now. Big shareholders also want him to go soon.

See article: Deputy heads will roll

The European Commission raided **mobile-phone companies** in Britain and Germany as part of an investigation into price-fixing on international charges in both countries.

Compaq Computer, the world's second-biggest PC maker, gave a warning that profits in its latest quarter would be down sharply. America's economic slowdown has intensified competition, and troubles have spread to Europe. A report from Merrill Lynch suggested further gloom; companies are spending

less on IT and delaying upgrades.

Microsoft is to allow PC makers more freedom to change the Windows desktop. The software giant's move follows an appeals court ruling criticising its Windows monopoly; it may thereby hope to improve its negotiating position in settlement talks over the government's antitrust suit.

Baltimore Technologies, once one of the most admired Internet companies, shed its chief executive, Fran Rooney. The Irish Internet-security company, once worth £5.1 billion ($8 billion), suffered a mini-collapse of its ever dwindling share price that took its value to as low as £120m.

Webvan, an American online grocer once valued at $8.7 billion, said that it would close with the loss of 2,000 jobs. The company had slowed its losses by abandoning extravagant expansion plans, but could not do enough to offset a rapid decline in orders.

Real Madrid paid a record *euro*77m ($66m) for Zinedine Zidane, a French international. The Spanish football club financed the deal and paid off debts by selling its training complex in Madrid's business district.

Opposite banks

As expected, the British government blocked an £18 billion ($25 billion) bid by **Lloyds TSB** for **Abbey National** on competition grounds. This will, in effect, put an end to consolidation among Britain's big banks; they may now seek targets abroad.

See article: Ellwood Agonistes

CSFB, a Wall Street bank under regulatory investigation for its handling of initial public offerings, ousted its chief executive, Allen Wheat. He will be replaced by John Mack, former president of Morgan Stanley.

Euronext, the outcome of a merger of bourses in Amsterdam, Brussels and Paris, made a poor showing on its own stockmarket debut. Its shares, traded on all three exchanges, fell by 8.5% on the first day despite being priced at the low end of the range.

Merrill Lynch, America's largest stockbroker, sought to reassure sceptical customers of the impartiality of its analysts by stopping them owning shares in companies that they cover.

FTSE International, a British stockmarket indexer, launched **FTSE4Good**, a set of stockmarket indices for socially responsible investment. Many of Britain's top companies failed to make the grade.

See article:"Best" behaviour

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Politics this week

Jul 12th 2001
From The Economist print edition

Portents

As General Pervez Musharraf of Pakistan and the Indian prime minister, Atal Behari Vajpayee, prepared to discuss peace for **Kashmir**, 15 people died in clashes in the Indian part of the disputed territory.

See article: It's good to talk

Gary Condit, an **American congressman**, admitted having covered up his affair with a missing intern, Chandra Levy. The police later searched the Democrat's apartment—11 weeks after Miss Levy had disappeared.

See article: Secrets, lies and hubris

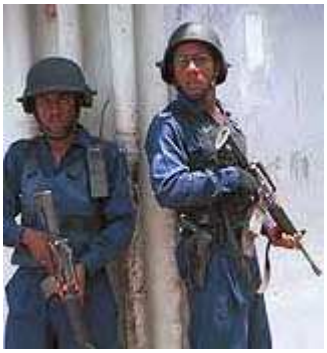
Squatters invaded land on the edge of Johannesburg. A court ordered them to leave and the **South African government**, anxious to differentiate itself from Zimbabwe, sent police to evict them.

See article: Space invaders

Riots in Jamaica

Violence erupted in **Jamaica**. The government called out the army after 25 people had been killed, most of them in gun battles between police and gangs with political links.

AP



See article: Burning

A row broke out in America after scientists announced that they had created **human embryos** in order to harvest stem cells. President George Bush has still not decided whether to let federal money go to stem-cell research.

Chile's appeal court ruled that **General Augusto Pinochet** was mentally unfit to stand trial on human-rights charges, bringing to an end a lengthy legal saga.

See article: He's demented

Meta politics

Albania's prime minister, Ilir Meta, and his Socialists were handsomely returned to power in a general election.

Reuters

See article: On the road to normality

In his native city of Split, huge flag-waving crowds welcomed **Goran Ivanisevic**, the wild-card Croatian winner of the men's singles at Wimbledon.

See article: Goran Ivanisevic

British and Irish leaders agonised together for days trying to save the crumbling peace process in **Northern Ireland**. The northern English city of Bradford saw Britain's worst race riots for years, between whites and (mainly British-born) Asians.

See article: Alone, together

Magistrates investigating **President Jacques Chirac**'s use of dubious funds questioned the French president's daughter Claude, an adviser on the media to her father.

See article: Gather round the trough

China on top

Hong Kong's legislature passed a law that would allow the Chinese government in Beijing to sack the territory's leader. Pro-democracy members of the legislature said the law eroded the autonomy of the former British colony.

A move to vote **Sri Lanka**'s minority government out of office was thwarted when President Chandrika Kumaratunga suspended parliament until September 7th.

In a new surge of violence in **Nepal**, where the royal family was murdered in June, some 40 policemen were killed by Maoist gangs.

Japan turned down pleas by South Korea and China to correct "distortions" in school textbooks dealing with its Asian conquests. South Korea broke off its (very limited) military ties with Japan.

Africa's new union

Reuters

African heads of government gathered in Lusaka for the 37th and final meeting of the Organisation of African Unity. The group will be known in future as the **African Union**, with, it is said, a commission, central bank and parliament. Amara Essy, a former foreign minister of Côte d'Ivoire, was elected secretary-general.

In a breakthrough at the **Burundi** peace talks, chaired by Nelson Mandela, the country's 19 political parties were said to have agreed that Pierre Buyoya, a Tutsi, should remain president for the first 18 months of a new three-year transitional government. A Hutu politician would be vice-president, and their roles would be reversed half-way through the term. Once a ceasefire has been agreed, South Africa, Nigeria and others will send peacekeepers.

In the latest of a string of political killings in **Zambia**, Paul Tembo, a former ally of President Frederick Chiluba who had defected to an opposition party, was shot dead a few hours before he was due to testify to a corruption inquiry. He had been expected to implicate several ministers.

Demolition tactics

The United States joined the European Union in condemning Israel for demolishing 17 **Palestinian houses** in Rafah refugee camp in the Gaza strip. Earlier, Israel had destroyed 14 houses under construction in a refugee camp in Jerusalem.

See article: Post-mortem on Black October

Israel, Hizbullah and the United Nations were involved in a row over a videotape taken at the scene of the abduction of **three Israeli soldiers** last year. The UN is prepared to show Israel the footage, but only on the condition that the faces of Hizbullah militants are obscured.

A leading Egyptian feminist, **Nawal el-Saadawi**, was accused of apostasy by a lawyer for allegedly saying the haj pilgrimage had pagan roots. A Cairo court is being asked to enforce her separation from her Muslim husband of 37 years. The case has been adjourned.

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Managing customers

Keeping the customer satisfied

Jul 12th 2001
From The Economist print edition

All customers are important, but some are more important than others

BEING a customer can be baffling these days. All that choice, all those special deals, all those companies eagerly telling you (as you wait on hold, listening to ghastly muzak) that "your call is important to us." On the face of it, companies seem keener than ever to sell you their stuff—as, in these leaner times, they should be. But why do you so rarely feel that you are getting special service, or that the company knows the faintest thing about who you are or what you really want?

Such questions apply whether you buy as a business or as an individual. And the common answer is that companies are stumbling to find new ways to manage their relationships with their customers. Somehow, they have to use the Internet and the rest of today's technological wizardry to cut costs, but at the same time to give people the sort of service that sends them away happy. Only happy customers will be loyal ones—and loyalty is something companies desperately need if they are to survive in today's difficult economic climate.

Competitors galore

Already, many companies find it more of a struggle than they did to win new customers and to keep those they already have. No surprise there: competition has sprung up from all sorts of new directions in the past few frenetic years, and it will intensify as the downturn makes customers both pickier and more cautious. Companies that do not respond can find that old loyalties evaporate quickly: Britain's Marks and Spencer is in trouble because it failed to spot that new clothing companies change their stocks almost as often as customers change their socks. The Internet has brought new competition into many established markets, and created some real new business models as well as the many bogus ones. Michael Dell, with his build-to-order manufacturing, has revolutionised the PC business; now, manufacturers of cars, white goods and other products are trying to do something similar, with the eventual goal of "mass customisation" (see article).

Plenty of once-promising newcomers have, admittedly, proved short-lived: yet another high-profile dotcom, Webvan, an online grocery firm, bit the dust this week. But the sheer quantity of information that now bombards customers makes it ever harder for even an established brand to maintain visibility, as well as terrifyingly expensive to build a new one. The Internet also threatens old loyalties by giving customers a new way to search for what they want. In America, notes the boss of General Motors, Rick Wagoner, "almost all" prospective car-buyers now look on the Internet first, and so turn up at the dealer's showroom knowing as much as he does about discounts and availability. Whether for holidays, CDs or mortgages, the Internet is giving restless customers unprecedented information on rival prices and special deals.

The arrival of new competitors and the spread of information have also raised the cost of acquiring new customers: more mailshots, more advertising, bigger welcome discounts. It thus takes longer for, say, a mobile-telephone company to earn back its initial investment. Companies have always known that it can cost three or four times as much to acquire a new customer as to make a repeat sale to an existing one. In hard times, and with growing competition, that arithmetic makes successful retention all the more crucial.

Keep them happy

Now, though, companies have all sorts of expensive new electronic gadgetry at their disposal to help them manage their customer relationships: vast databases, fancy software for “mining” them, intranets and extranets. So far, most have found it hard to use it effectively: one recent survey found that about two-thirds of customer-relationship-management projects fail. The trick is not merely to cut costs, but also to retain old-fashioned values of customer service.

The wrong approach is all too obvious on many of those corporate websites that offer self-service help. Some customers may be able to find the answer to their own questions more quickly on a website than on the telephone, especially if the latter involves waiting on hold for 20 minutes. But those who e-mail a company with a problem expect a quick, clear reply; and plenty of others want to speak to a human being. When websites are designed merely to keep questions at bay, the customer may get the message and not come back.

The right approach to retaining customers starts with trying to understand more about them, and then to work out what to do with the knowledge. Electronic communications offer companies unprecedented quantities of information about who buys what from them. The department store can discover that your waistband has expanded an inch or so since last year, the airline knows that you usually fly with its main rival, the restaurant remembers that you drink Pinot Grigio. But such information creates as many difficulties as opportunities.

As Das Narayandas, a Harvard Business School academic, points out, the bit of the company that collects information when the customer buys is not usually the bit that uses it for selling. Besides, if the marketers for one product build their own database, they may resent it when another division wants to tap in. “These are our customers,” they will say. “We don’t want you spoiling our relationship by blitzing them with your own cold calls. What’s more, the costs of assembling the data burdens our accounts—you just get the profits.” Such turf wars make a mockery of companies’ efforts to present a single face to the customer.

Companies should think more clearly about the information they collect. That task will grow more urgent as customers (and regulators) start to fret about invasions of privacy. They may want more control over what companies do with the data they collect, and they will expect something in exchange for providing it. Join a good loyalty club (as opposed to the many shams) and you may part with lots of information about your income and tastes that you would not otherwise divulge.

Firms are more likely to collect information sensibly and thoughtfully if they know why they want it. One likely use is to offer different deals to different customers, trying to tie in the most valuable ones with keener prices than the others get. Skilful use of data allows companies both to spot which customers are worth fighting for (the frequent flier, the account holder with a big loan and a regular job) and then to offer them hefty discounts, to reduce the risk that a competitor will poach them. In principle, customers hate the idea of price discrimination—as Amazon, an online bookstore, discovered when it charged customers different prices for the same book. In practice, they accept special offers to members of a loyalty club, or to people who book tickets early or keep a big balance on an account. They accept “bundled” deals, such as free talk-time on a cellphone if you upgrade your handset. In future, “good” customers will routinely expect to pay less for a service (or get more for their money) than the rest of us.

In the end, durable customer relations are only partly about clever technology, however imaginatively used. Mainly, they require relentless attention to detail: good products, prompt service, well-trained staff with the power to do a little extra when they judge it right to do so. No wonder firms that send you away with a smile on your face are so rare.

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Weapons of mass destruction

A proliferating problem

Jul 12th 2001
From The Economist print edition

It is in the interests of Russia, China and the West to tackle it

JUST about everyone bar the culprits agrees that the spread of nuclear, chemical and biological weapons, as well as missiles to deliver them, will pose the biggest threat to international peace and security in the 21st century. The countries that between them could do most to prevent ne'er-do-wells getting their hands on such weapons are now set for a series of diplomatic huddles: this weekend the presidents of China and Russia will sign a new friendship treaty; next weekend Russia joins the United States, Canada, Japan and the bigger Europeans for their annual G8 summit. Yet non-proliferation is top of neither agenda. That is a pity, for some 20 countries are dabbling in the technologies of mass destruction and there is much more that could be done to thwart them.

In Moscow the presidents of China and Russia will be professing peace, though no country, except North Korea, has done more to help those bent on disrupting it. Despite international agreements to control or ban nuclear, chemical and biological weapons, their companies—sometimes with official connivance, sometimes without it—have long been bespoke armourers in mass destruction and purveyors of missile technology to anyone with enough cash. Russia's government recently sold nuclear-reactor fuel to India, breaking a ban on such trade with countries that refuse full international safeguards on their nuclear activities. China treats its non-proliferation promises to the world as concessions to America, threatening to break them when piqued.

Both China and Russia have assumed this threatens western interests, not their own. But now both worry that America's plans to develop missile defences to cope with the proliferation damage done could eventually undermine their own nuclear deterrents too. They argue that defences will only provoke further proliferation—and, depending on how America goes about things, they could indeed be right. A new set of stability-preserving understandings between America and Russia to augment or replace the long-standing Anti-Ballistic Missile treaty could perhaps help to avoid that. But stemming the destabilising flow of weapons know-how is just as crucial.

Safety costs money

European governments, by contrast, like to bask on the moral high ground: they are tough on rule-breaking firms and keener to talk up non-proliferation than missile defences—while now accepting that defences of some sort will have a role against potential new threats. They have argued hard for the ratification of the Comprehensive Test-Ban Treaty by all countries—including America, whose new administration, like the Senate, opposes it—and are pressing for new rules to strengthen the ban on biological weapons, despite American doubts. But high-minded diplomacy will not achieve much without more money and effort to back it up.

Recently, the European Union increased its contribution to KEDO, the organisation supervising a deal to end North Korea's production of plutonium: from a derisory $75m over the past five years to a derisory $87.5m over the next five (peanuts for a project that will cost upwards of $5 billion). Similarly, rich Europeans living right next door contribute much less than more distant Americans to the dismantling of Russia's surplus nuclear and chemical weapons, and the safe storage of bomb-making plutonium and uranium.

Furthermore, the Europeans have not yet ratified the new verification rules proposed by the International Atomic Energy Agency (IAEA) in 1997 to help detect undeclared nuclear activity. Until developed countries implement them, it will be hard to lean on potential or suspected rule-breakers elsewhere to do so. Meanwhile, the IAEA is hard pressed every year to scrape together the $80m needed to meet its inadequate safeguards budget. Like other UN organisations, it has long been denied a budget increase, despite a proliferating workload. Of the G8 crowd, Canada, Germany and Japan are the most tight-fisted, leaving the agency dependent on America for extra-budgetary cash. Diverting just a tiny fraction of the money the EU and Japan spend on wasteful subsidies for this and that would make a huge difference to the job the agency can do.

In the fight against proliferation, the actions of governments are too often counter-productive, too little or too late. Someday they will regret it.

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Britain's Conservative Party

The masochists' derby

Jul 12th 2001
From The Economist print edition

To become attractive again, the Conservatives need to be liberal, non-dogmatic Eurosceptics

AT MIDWEEK, as *The Economist* went to press, the three front-runners in the race to take William Hague's place as leader of Britain's Conservative opposition were Michael Portillo, Kenneth Clarke and Iain Duncan Smith. The final result will not come for at least a month, when the constituency party delivers its verdict; this week and next, the parliamentary party is whittling the field down to two. Each of the front-runners has his personal flaws and attributes, but it so happens that the candidature of each also requires the Tories to ask themselves a searching question about what their party now stands for. The choice looks—and is—too neat to be true.

Mr Portillo wants Conservatives to become less conservative. He has to: just before returning to Parliament in 1999, the man whom many had considered the true heir of Margaret Thatcher scandalised the fustier Thatcherites by admitting that he had experimented as a young man with gay sex. Such a confession would once have been terminal to a potential leader's career, but Mr Portillo has tried to turn it to his advantage. The Conservatives, he says, got their economics right under Mrs Thatcher. But to restore themselves to power they need now to adapt their social attitudes as well, by being more welcoming to ethnic minorities, more open-minded on matters such as cannabis, and more tolerant of people whose sexual and social choices differ from their own.

Mr Clarke wants Conservatives to make less of a fuss about the euro and the European Union. He has to: as an enthusiast for the euro (though not for joining quite yet), he is entirely out of sympathy with the policy that Mr Hague put at the centre of his general-election campaign, and on which the Conservative MPs Mr Clarke is now wooing were elected. But like Mr Portillo, Mr Clarke hopes to turn an awkwardness to his advantage. Since an obsessive campaign against the euro has just sent the party crashing to defeat, his supporters say, a Clarke leadership would help it to abandon a disastrous policy.

Mr Duncan Smith is the opposite of both men. Though by no means Attila the Hun, he has placed himself to the right of Mr Portillo on social matters. On the European Union, he is even more sceptical than Mr Hague was, let alone Mr Clarke. Mr Hague talked the party into ruling out British membership of the single currency for the lifetime of at least one Parliament. Mr Duncan Smith, opposed "on principle", would never want the country to join. As the most fussed of the three about the threat the EU's "ever-closer union" poses to British sovereignty, he might even favour Britain withdrawing from the European Union altogether.

The men and their messages

How should Conservatives choose? Mr Portillo's message of social liberalism may be self-serving, but it is also right. It would fit properly and logically with the economic freedom the Tories have stood for since the 1970s. A party that campaigned to minimise the role of the state in both spheres could well appeal to the many voters who cannot support the Liberal Democrats' left-ish economics, but who are uncomfortable with the sermonising, authoritarian streak in Blairism.

Europe is harder to resolve. Mr Duncan Smith is wrong to say never to the euro. A leader who claims that it will never be in Britain's interest to join the single currency is pretending to know more than it is possible to know about the future—and he would surely have to resign on the morning after a euro

referendum in which Britons voted to join, which could happen as early as autumn next year. On the other hand, Mr Clarke is wrong to say that the party lost the general election because of the euro. Most polls suggest that voters agreed with the Tories on this. The Tories may have lost because the party seemed to care about little else, but that is a different matter.

It is easier to describe an ideal party than to identify its ideal leader. That party would be liberal on social issues as well as economics, sceptical about Europe but not dogmatically opposed to all its doings, and capable of producing bolder ideas than Labour has come up with for extending consumer choice in public services. None of the front-runners fits the bill exactly. Mr Duncan Smith is no liberal and a dogmatist on Europe. Mr Clarke can pose as a liberal but might split the party if he is not able to moderate his zealot's enthusiasm for the single currency. Mr Portillo has got his present mix of ideas about right, but his ideas have changed so much and so recently that it is reasonable to doubt his attachment to them. Good luck.

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India and Pakistan

It's good to talk

Jul 12th 2001
From The Economist print edition

This weekend's Indo-Pakistani summit may bring hope of progress on Kashmir

AP

EVEN buttoned-up North Korea talks to its adversary in the south more readily these days than Pakistan and India. Not since February 1999 have these subcontinental foes held a summit meeting. Considering that both are now declared nuclear powers, who have fought three wars in the 54 years since independence and a nasty little battle only two years ago, the failure even to talk is a large part of the reason why their border is often regarded as the world's most dangerous place.

This weekend, in the shadow of the Taj Mahal—a Muslim monument that should act to remind both sides of their common heritage—Atal Behari Vajpayee, prime minister of India, and General Pervez Musharraf, self-appointed president of Pakistan, aim at least to end the hostile silence. Some good news could well be forthcoming about a possible gas pipeline connecting Iran and India via Pakistan, and India has warmed the temperature in advance with an offer this week to open border-crossings to its west. But all attempts to improve relations between the two countries are liable to founder fast unless progress is made on the most intractable issue: the fact that India controls the mainly-Muslim state of Jammu & Kashmir in apparent defiance of the wishes of its people.

Kashmir holds all else hostage. It would, in theory, be possible for India and Pakistan to agree to differ over the disputed state and get on with all the other things that urgently need to be talked about: nuclear weapons, troop levels, cross-border trade, water supplies, pipelines and much else. Other countries have managed this. Turkey and Greece have been able to move beyond their differences over Cyprus. Britain's disputes with Spain over Gibraltar and with Argentina over the Falklands are now no obstacle to good relations in other areas.

But in practice, such a solution is not feasible. Anything that smacks too obviously of acceptance of the status quo would in effect mark a victory for India, and a deep humiliation for Pakistan. Although Pakistan holds a chunk of Kashmir (and China another) which India says it must have back, the reality is that India already possesses the most populous places. Despite its rhetorical demands, India would surely be happy to accept the existing "line of control" dividing Indian-held Kashmir from the Pakistani-held bit as a border if that meant Pakistan's abandonment of its claims there. On the last occasion that Pakistan and India met at summit level, in Lahore, something close to setting Kashmir to one side in the interests of the wider relationship was tried: it proved so unpopular with Pakistan's army that three months later it launched an incursion into Indian Kashmir that scuppered the Lahore process.

India knows that it cannot afford a return to complete breakdown in its relations with Pakistan. America, which has pushed hard for the Agra summit to take place, has enthralled it with the offer of close friendship. But America has also made it clear that India cannot take up the place it thinks it deserves as a regional superpower while it is still fighting a running battle with its neighbour. And the foreign investment India needs would be more likely to flow if the threat of war were removed. So India may now be prepared to make concessions. Pakistan, too, badly needs a deal if only it can be presented as something short of a sell-out; the general is under even greater American pressure than India is, thanks to the far more parlous state of Pakistan's economy (see article).

The road to peace?

It is far too early to talk of peace in Kashmir. But there is some reason to hope that the Agra summit may mark the beginning of something that might reasonably be called a peace process. India is already exploring the possibility of talking directly to representatives of Kashmiri groups it formerly considered too militant to touch. There is some reason to hope that Pakistan may be ready to be creative about what was once an inflexible demand that any talks with the Indians should be tripartite, involving the Kashmiris throughout as equal partners.

And, dimly in the distance, the outlines of a peace deal may be glimpsed: acceptance by Pakistan of something less than Kashmiri secession from India in the form of a much higher degree of autonomy within it, which Pakistan could portray as a kind of victory. The line of control might become a relatively open international border, which would allow the Kashmiris to move freely within their entire state. The Kashmiris might even get recognition of their separate identity in their (Indian) passports. Crucial to this bargain would be a substantial reduction in the number of Indian troops in Kashmir, in return for Pakistan's reining in of the militants it sponsors there. To settle for less than full self-determination for Kashmiris in the face of Indian unwillingness to cede any of its territory would be a bitter cup for Pakistan to drain. But at least the general has no voters to worry about.

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Zimbabwe

Pressure now

Jul 12th 2001
From The Economist print edition

If Zimbabwe is to have a fair election next year, the checking should start now

Reuters

WHEN a president decides to destroy his country, it is hard to know how to stop him. President Robert Mugabe seems determined to take Zimbabwe over the precipice. He has ruined the economy, overridden the law and undermined its institutions, all so that he and his cronies can stay in power.

The main opposition party, the Movement for Democratic Change, managed to defeat a referendum to change the constitution last year but narrowly failed, four months later, to win a parliamentary majority in an election dominated by government violence and intimidation. Fearing that demonstrators would be shot, the MDC has decided against calling people out on to the streets. A national strike last week, though well-supported, has simply damaged the economy further without apparently hurting Mr Mugabe (see article).

Aid-giving countries, too, are in a quandary. They have cut off most of their assistance, but Mr Mugabe does not care. Rather, he has sought to turn Britain's strident criticism to his own advantage by portraying himself as an African patriot spitting in the eye of British imperialism, even though his "land-reform" programme is plainly directed as much at destroying the opposition and rewarding his supporters as it is at redistributing white farmland. And, at least elsewhere in Africa, his cries have found an echo. The foreign ministers of the Organisation of African Unity, meeting in Zambia last weekend, gave him all the backing he could have wished for, though the heads of government were more circumspect, perhaps influenced by President Thabo Mbeki of South Africa.

Surprisingly, though, Mr Mugabe may have some chinks in his armour. Though 77 years old and in power for 21 years, he wants to be voted in again as president in an election that must be held before next April. He may be a dictator, but he wants to show he is a popular one. This gives the opposition a chance. It is urging Zimbabwe's friends to keep pressing the government to ensure that the election is fair and free of intimidation.

Mr Mugabe has a second weakness, which may make this possible: he also wants the approbation of the Commonwealth. Earlier this year he angrily rejected a proposed visit by a team of Commonwealth foreign ministers, which is the organisation's polite way of rebuking undemocratic members. But he has now been persuaded by Mr Mbeki and others to accept a less formal meeting under the broad umbrella of the Commonwealth. If it goes ahead—nothing is certain—this could provide an opportunity for the Commonwealth to try to promote fair play in Zimbabwe: it should say that it will not be associated with the meeting unless it can at once start checking on the conduct of next year's election.

Why so soon? In too many devious tyrannies that hold elections, outside observers arrive as the polling stations open and never see the process of rigging, disqualification or intimidation that has already made a mockery of the voting. If that is not to happen next year in Zimbabwe, independent electoral monitoring organisations need to start gathering information now on all aspects of the election: the voters' roll, intimidation, the use of government funds and facilities, and so on. The constitution already gives the president an advantage in parliament by allowing him to appoint 20 of its 150 members (ten others go to traditional chiefs).That may, in the event, enable Mr Mugabe to hang on to power. But if he does so by stealing the election, outsiders must be ready to condemn it and reject the result. They should begin watching now.

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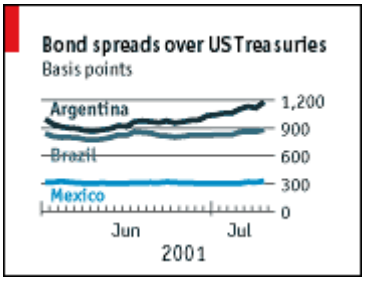
Latin America's economies

Gloom over the River Plate

Jul 12th 2001
From The Economist print edition

Argentine, and other, woes are dragging the region down



RARELY in the past decade have the prospects for Latin America's economies seemed so threatening. This week Argentina's shaky government struggled to sell treasury bills to a largely captive domestic debt market. Brazil's currency, the *real*, continues to sag: it has lost more than 22% of its value since January, despite interest-rate rises and intervention by the Central Bank. Chile's normally buoyant peso has slid against the dollar too, and the Andean countries have countless problems of their own. Even Mexico's economy is cooling fast, its exports hit by shrinking demand in the United States.

Between them, Argentina and Brazil account for about 40% of all emerging-market bonds. With investors fretting, too, about Turkey's commitment to its economic-reform programme, and renewed doubts about East Asia's economic prospects, once again there is talk of financial contagion spreading across all emerging markets, as in 1997-99.

Certainly, the exceptional strength of the dollar has hurt many emerging economies—and none more than Argentina, whose currency board pegs its peso at par to the greenback. But many of the difficulties in South America are home-grown. Take Brazil. Only months ago, it seemed set fair for several years of quickening growth, reward for the reforms pushed through by President Fernando Henrique Cardoso.

Enter the unexpected. First, Mr Cardoso's loose, four-party centre-right coalition frayed, partly because of corruption scandals. Second, an energy shortage obliged the government to impose rationing aimed at cutting electricity consumption by a fifth. As a result, the central bank has slashed its forecast of this year's economic growth from 4.5% to 2.8%.

Lack of rain is partly to blame; Brazil depends heavily on hydroelectricity. But there is a human factor: the government bungled (and only half-completed) the privatisation of the electricity industry. Brazilians have been quick to blame Mr Cardoso, seemingly improving the chances that the left-wing opposition will win next year's presidential election.

That is one reason for the *real*'s plunge. But there are others. Foreign investment has slowed. And a weaker *real* brings its own difficulties, such as the likelihood that inflation will exceed the central bank's target. But above all, the *real* is wilting because of Brazil's proximity to Argentina.

Many Argentines hoped that Domingo Cavallo, appointed as economy minister in March, would perform miracles. He has not. Argentina's economy remains trapped in a slump that has now lasted three years. A huge bond swap completed last month was supposed to banish fears of a debt default. But the risk premium on Argentine debt has again soared, despite a deal between Mr Cavallo and the country's provincial governors, who agreed to cut spending by an ambitious (and probably unachievable) $1.6 billion in a year. This week Mr Cavallo was frantically seeking other cuts (see article).

Brazil's problems still look manageable, though the central bank would be wise to let the currency slip: intervening against the market is a sure way to lose money. Argentina is a different matter. It is fast running out of time. Neither Argentines nor investors have any confidence in Fernando de la Rua, the country's weak and vacillating president. But Mr Cavallo has himself stoked the worries, with an ill-conceived decision last month to pay a subsidy to exporters and levy a tariff on importers, raising fears of an end to the currency board.

Thanks to the bond swap and the IMF, Argentina has no need to raise funds in international markets this year (though it must roll over $8 billion in the domestic debt market). Mr Cavallo's tax changes appear to have shored up sagging revenues. Were Mr de la Rua capable of delivering several months of political calm, and were the dollar to weaken, Argentina might yet scrape through. But do not bet on it.

Low savings, high dependency

The underlying cause of Latin America's problems is easy to diagnose, but far harder to overcome. Despite a decade of market reform, the region remains dangerously dependent on foreign capital. Since that has now become scarce for all except Mexico, at best Latin America faces a period of slower growth, until it increases its savings, both public and private, and boosts its exports. That will take a fresh reform effort. And in Argentina the prospect of a financial meltdown, involving a forced default and a devaluation, has moved closer. That would batter confidence throughout South America, and might well detonate another worldwide emerging-market crisis. Cross your fingers.

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Letters

Jul 12th 2001
From The Economist print edition

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Amount of olives

SIR – I have argued within the European Parliament for radical change in the olive-oil regime, decoupling it from production and transforming it into a subvention to rural manpower and the environment ("Glut, fraud and eco-damage", June 30th). In the parliament most of my proposals on olive-oil reform were defeated by a close margin. The opposition came from conservatives, both from northern and southern Europe, who voted overwhelmingly against the reform. Southern socialists mostly voted in favour.

The reason is clear. When reform is approved for olive oil it will be very hard to stop it for arable crops, sugar, beef, milk and other sectors, and this alarms those who are stubbornly opposed to any change—both in northern and southern Europe.

Paulo Casaca, MEP
Ponta Delgada, Portugal

SIR – You fail to cross reference the article on EU subsidies for olives with the coverage of British bestsellers ("What the world is reading", June 30th). There one discovers that "there is olive oil all over the non-fiction list", not only in cookbooks but also in the bestselling stories of two women who have become olive growers in Italy and France. All, no doubt, encouraged by EU subsidies.

Carlo Monticelli
London

Western Sahara's future

SIR – Your article on Western Sahara ("The UN's U-turn", June 30th) contains information about the framework agreement on the status of Western Sahara that I helped draw up and that is, I believe, inaccurate. First, you say that there "may—but only may—be a referendum". In fact the agreement says there will be one within five years.

Second, you say that "the UN now appears to have decided to abandon" the settlement plan. In fact, the secretary-general's report to the Security Council says "the settlement plan will not be abandoned." And Security Council resolution 1359 of June 29th 2001 affirms that by engaging in negotiations over the framework agreement the parties will not prejudice their final positions. The resolution also provides that while discussions regarding the framework agreement go on, proposals submitted by the Polisario Front to overcome the obstacles preventing implementation of the settlement plan will be considered. Third, you say Morocco would be "responsible for law and order during the transition." The framework agreement plainly assigns exclusive competence for "law enforcement" and "internal security" to the population of Western Sahara. Fourth, you say that the proposed executive "will be responsible to [the] assembly". The relationship of the executive and the assembly is not laid out in the framework agreement and would be determined by negotiation.

Finally, let me answer the question posed at the start of your piece: "Has the UN's new plan for Western Sahara dropped self-determination?" The answer is an unqualified no. As the secretary-general says in his report: "The proposed framework agreement is not unlike agreements used to address similar situations elsewhere, where a devolution of authority to the inhabitants of a non-self-governing territory is granted with the final status of the territory to be determined by a referendum." In the light of the

complexity and importance of these matters, it is hoped that you will exercise the utmost care in reporting them.

James Baker
Houston

Phone-line shopping

SIR – When I was younger I used to work at a grocery store in my home town. One of the shopkeeper's advantages over the big retail chains that constantly grabbed his customers was his taste for personal service ("Surfing USA", June 30th). Old people in the neighbourhood, who were often unable to get out of their houses let alone carry home bags full of groceries, would gladly pay the small fee my boss would ask to take their shopping order by phone and deliver everything to them a few hours later. But my boss was not a "phone-business" man. He was a shopkeeper. When will you, and everyone else, realise that the Internet is a communication tool; no more, no less.

Rurik Oprita
Paris

Patently absurd

SIR – Your defence of the patent system is not convincing ("The right to good ideas", June 23rd). The system works best not for the inventor but for a rich company that has the money to get good patent lawyers and fund litigation to protect a monopoly. It is not the person with a good idea who wins but the clever, fast and rich. The game is further rigged by the fact that patent processing in America is not a sequential process (first in, first out) but a high-speed race in which the well connected and more aggressive win.

J.E. Dumont
Brussels

Protecting prostitutes

SIR – You report claims that the Albanian Mafia has taken over Soho ("SoHopeless", June 23rd). This is a government fabrication aimed at justifying a police clampdown on prostitute women there and laying the basis for anti-trafficking legislation that would increase police powers at women's expense.

In 1999, we successfully opposed attempts by Westminster Council to evict women from premises where they live and work. Many women would have been forced on to the streets where it is ten-times more dangerous to work. In February this year, the Metropolitan Police's Vice Unit and immigration officers raided the flats of 60 immigrant women working in Soho. They had fled war and devastation—including in Iraq and Kosovo. Some were mothers of young children and had pending asylum claims with the Home Office. They were dragged from their flats in front of TV cameras, arrested and summarily deported.

The raids, based on false police claims that children and women had been trafficked and were being held against their will, were publicly condemned and their legality challenged by women's groups, prominent lawyers, MPs and church people. Not expecting to be called to account, the Vice Unit attempted to justify the raids. First, it claimed to be "protecting under-age children". None were found. It then said it was "liberating victims of trafficking". No pimps or traffickers were discovered. Next, it said the raids were "part of a wider initiative to support Westminster residents". The Soho Society, which represents residents, condemned the raids.

Whoever we are, if we face violence we need protection not deportation. *The Economist* should oppose this government and media witchhunt against immigrants and asylum-seekers.

Cari Mitchell
English Collective of Prostitutes
London

Lawyerless in Texas

SIR – Audrey Cheng (Letters, July 7th) supports her argument that Texas is an undesirable place to live

by noting that it attracts few out-of-state lawyers. Perhaps not everyone would consider this a shortcoming.

Coulter George
Cambridge

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Are generals good for you?

Jul 12th 2001 | ISLAMABAD, LAHORE AND PESHAWAR
From The Economist print edition

General Pervez Musharraf suspended democracy in order to sort out Pakistan. So far, success is limited, and democracy may be a long time returning

Reuters

HE IS a general who calls himself president, but he sees himself as a saviour. "I have a job to do here and therefore I cannot and will not let the nation down," declared Pervez Musharraf upon appointing himself president of Pakistan on June 20th. There is no doubt that Pakistan needs saving. It is deeply in debt and poverty has been rising. It is an Islamic federation regarded as insufficiently Islamic by zealots and imperfectly federal by most of its ethnic groups. Many of the malcontents are armed. Formally, Pakistan calls itself a democracy, but it has no sitting parliament.

If Pakistan were a run-of-the-mill third-world dictatorship, few apart from its 134m citizens would care. But Pakistan is not ordinary. It is the world's seventh declared nuclear power, at bitter odds with the sixth, India. It is the chief sponsor of the dread Taliban government in neighbouring Afghanistan and itself a nursery for groups of all sorts that seek to wed politics to intolerant versions of Islam. The possibility that Pakistan might someday fall into the hands of religious radicals concerns not only India but China (now a friend), the United States and others. The number of people who ought to care how well General Musharraf does as saviour runs into the billions.

His biggest opportunity since seizing power in October 1999 will come on July 14th, when he is to meet India's prime minister after more than two years of angry silence between the two countries. The summit is important for India, too. Its half-century-long dispute with Pakistan over Kashmir, a Muslim-majority state now parcelled out among the two old foes and China, costs India men, treasure and reputation. Without coming to terms with Pakistan, India is unlikely to assume what it regards as its rightful place in the world, which includes a seat on the UN Security Council. But for Pakistan the stakes are still higher. The conflict with India sustains a gigantic military establishment that has been ruinous both for the exchequer and for democracy. To keep a proxy war going in India's part of Kashmir, Pakistan sponsors mujahideen who, fear liberal Pakistanis, could turn their guns and their ideology on Pakistan itself. Peace could liberate Pakistan from these burdens.

Hope flies in the face of intuition and history. It supposes that a military man can make peace with India, thereby diminishing the institution that made him. It suggests that a president who has arrogated to himself near-absolute power can create the basis for a durable democracy. It implies that a country that for more than 20 years has pursued its foreign aims by exploiting religious zealotry can now tame it. It has not happened before, and most Pakistanis do not expect it to happen now.

Reform deferred

Such legitimacy as General Musharraf's regime enjoys depends on the awfulness of what came before. Nawaz Sharif, the prime minister he toppled, was democratically elected but behaved like an autocrat, shearing the presidency of its powers and undermining the judiciary. While talking to India of peace, he authorised an incursion into Indian-controlled Kashmir that ended in a humiliating pull-out. The economy tottered on the verge of default.

In taking power from him, General Musharraf promised relief. He would bring "true" democracy in place of Mr Sharif's "sham" one. The corrupt would be hounded, but even-handedly. The economy would be revived and "inter-provincial disharmony" quelled. Mr Sharif had flirted with theocracy, but General Musharraf asked clerics to practise tolerance.

So far, he has disappointed most Pakistanis. The regime's favourable rating has slumped from 57% at the start of its tenure to 23% now. Ijaz Gilani, director of Gallup, a polling firm, describes the government as "friendless but tolerated". The main organised opposition is the Alliance for Restoration of Democracy, more than a dozen parties (including those of Mr Sharif and Benazir Bhutto, a former prime minister), which the general has so far kept in line by banning political rallies. The only people who seem happy with him are international agencies, such as the IMF, which underwrite Pakistan's economy.

The time has come when General Musharraf will no longer be able to rule without leading. The summit will oblige him to begin to clarify where he stands on India and Kashmir. The next month or two will show how serious the government is about "deweaponisation", its programme to disarm anyone, including religious extremists, who holds illegal weapons. August will mark the debut of devolution, which promises a revolution in local government but evades the highly charged question of where the provinces fit in.

At the upcoming summit, General Musharraf will be obliged to clarify his stand on India and Kashmir

The Supreme Court has given General Musharraf a nearly free hand to amend the constitution but a deadline for doing so: he must hold elections by October 2002. If his constitutional changes are to gain democratic assent, he must now start consulting political parties, which he regards as the root of most of Pakistan's problems. His rule will be considered a success only if he accomplishes a paradox, using the untrammelled power he has acquired to give power away.

Some glimmers of light

General Musharraf is trying to resolve by fiat contradictions that were embedded in Pakistan at its creation. Islam was the reason for carving Pakistan out of India in 1947, but the chief carver, Muhammad Ali Jinnah, was for most of his life secular in outlook. Pakistan remains uncomfortably poised between the two world views. Its four provinces are also mismatched. Punjabis account for more than half the population, dominate the army and bureaucracy and, say non-Punjabis, exploit the wealth of other provinces.

Pakistan's unsettled state encourages caricature. The back-and-forth between military and civilian governments is the stuff of *opera buffa*, the corruption tragi-comic. Armed mullahs are thought to roam about like turbaned gunslingers. Political and sectarian disputes can be lethal, periodically turning cities like Karachi into virtual war zones. The population is mostly rural and pitifully poor. Many see Pakistani society as feudal: the serfs supply their lords with votes as well as labour.

There is truth in these images, but they obscure the extent to which Pakistan has modernised despite its frail economy and exploitative political class. The literacy rate in 1998, according to the census, was 45%, still far too low but 20 points higher than it was in 1980. Electrification of rural households rose from 16% to 61% during the same period. Terrestrial television, which shows state-owned channels, reaches 75% of urbanites and half the rural population. The share of parents who want their daughters to have at least a college education has doubled to 60% in the past decade.

Pakistan is also more urban than its reputation. Reza Ali, director of the Urbanisation Research Programme, points out that city outskirts and "ribbons of development" along roads, especially in Punjab, have population densities and economies that resemble those of cities. Although the census classifies a third of the population as urban, Mr Ali calculates that the share of Pakistanis living in urban conditions is close to half.

Pakistan is both more modern, and more urban, than its reputation

General Musharraf must deal with these novelties as well as the clichés. So far, though, his most notable achievement has been the accumulation of power. In this he has not been far different from his civilian predecessor, Nawaz Sharif. The courts are no less beholden to him. The Supreme Court has taken an oath under the "provisional constitutional order", with which he installed himself in power. His stand-in as president when he is away is the chief justice. The drive for accountability, through a special office that investigates and prosecutes corruption, has largely bypassed the military and judiciary; it is seen as more effective but little more even-handed than Mr Sharif's.

The slap of firm government

When the time comes, General Musharraf may find it awkward to restore democracy. Under the constitution, the president is elected by parliament and the four provincial assemblies. If elections to these houses are free, they are likely to be packed with politicians hostile to his rule. General Musharraf will be tempted to rig them, or find some other way to remain in power. “There will be no election,” predicts Haji Mohammad Adeel, a former deputy speaker of the dissolved assembly of North-West Frontier Province (NWFP). Although General Musharraf has refrained from imposing martial law, some analysts suspect he eventually will.

He has inducted more uniformed men into civilian institutions than previous military rulers, says Hasan Askari Rizvi, an observer of the armed forces. Military monitoring teams have been dispatched to most nooks and crannies of the bureaucracy with a mission to discourage graft. There is a justification for this pushiness: the claim by the top brass that they alone can provide technocratic rule.

Comparing General Musharraf with previous governments, economists give him highish marks. For the first time in its history Pakistan is staying on a course of therapy, prescribed by the IMF, which entails cutting subsidies and tariffs and other politically unpleasant measures. It is no longer in immediate peril of default on its $37 billion external debt, and now has some prospect of climbing out of the financial hole into which earlier governments had plunged it.

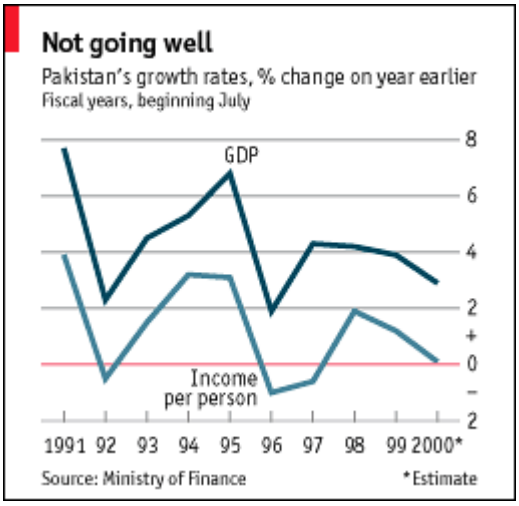
Institutions that largely preyed on the public are being told to serve it. Independent commissions are being set up to hear citizens’ complaints against the police and if necessary recommend (though not carry out) dismissals. The generals, it is said, have banished corruption from the top ranks of government.

Many foreigners involved in helping Pakistan give its military government good reviews. “Pervez Musharraf is the best thing that happened to this country in years,” says Simon Gillett, who until recently helped run a development project connected with the UN’s drug-control programme. But the list of only-the-army-can-do-it reforms is lengthy, and there is some shying away from battle. The government has so far ducked the restructuring of the notorious Central Board of Revenue, whose corruption robs the state of income and discourages businessmen from investing. Officers or ex-officers have taken over institutions that are ill suited to management by command, such as universities.

Better administration has yet to thrill ordinary Pakistanis. Although Pakistan is financially more stable, the economy is weak. Drought held growth to just 2.6% in the fiscal year ending in June, barely faster than the rate of population increase. Pakistanis complain of unemployment and rising prices, though official inflation rates are moderate. Despite General Musharraf’s promises of continuity in economic policy, investors—both foreign and domestic—are staying away.

Despite promises of continuity in economic policy, investors are stying away

Pakistan’s most explosive problems are unlikely to be solved in a democratic limbo. In the smaller provinces resentment against the centre is running high, though few Pakistanis are outright secessionists. “GHQ [General Headquarters] decides the fate of our province,” says Mr Adeel of NWFP. “Provinces are more unhappy now than before.” This is truest of Sindh, the second-largest province, which has been hit especially hard by the drought. The belief that Punjab is drinking Sindh’s water helped forge an alliance between groups usually hostile to one another: *mohajirs*, descendants of immigrants from India living mainly in Karachi, and Sindhi nationalists drawn from the rural population. In a demonstration on June 10th police killed two Sindhi activists and injured dozens of protesters. The main *mohajir* party, the MQM, boycotted the local election in Karachi on July 2nd.



Sindh has also seen sectarian violence, most recently between doctrinally strict Deobandis and the more relaxed Barelvis. The murder of a Barelvi leader prompted his armed adherents to impose a statewide “curfew” on May 28th. General Musharraf declared that such extremists represent no more than 1% of the population. That shopkeepers were nonetheless too scared to open up is, as one columnist wrote, “a severe indictment of the state.”

Devolve and disarm

General Musharraf's hopes of dispelling such doubts hang largely on three initiatives. The first is devolution of power to local bodies. Historically minded Pakistanis sneer. An earlier dictator, Ayub Khan, used such a scheme to give the illusion of democracy and cement his position in power. Soldiers, instinctive centralisers, like local democracy in part because it distracts attention from provincial issues, which are the real challenge to Pakistan's architecture.

General Musharraf has not proved the cynics wrong, but the scheme has features that make it worth watching. One is its attempt to encourage participation in politics by segments of society that have largely been excluded. All three tiers of local government have assemblies with a third of their seats reserved for women, a revolutionary notion. Seats are also reserved for peasants and workers, though a minimum educational requirement will bar many of them from advancing to the post of *nazim* (administrator). In theory, local services such as schools and health clinics will be held accountable by citizen community boards, which will report on them to committees of the local council.

General Musharraf's scheme would encourage political participation by women, peasants and workers

Also revolutionary is the subordination of the bureaucracy to elected officials. Under a system inherited from Pakistan's former British rulers, district commissioners are nearly omnipotent in their realms, with administrative, police and revenue responsibilities. Under the new system, a district co-ordination officer will manage the dozen functions assigned to the districts. He is expected to be shorn of judicial and revenue-raising powers and to answer to the district *nazim*. The bureaucracy is furiously resisting. Lastly, the plan brings rural areas, for the first time, into a framework for obtaining municipal services. Mr Ali, partly a sceptic, describes this as a "giant step".

In the eyes of some critics, the local-government scheme is perhaps too deeply flawed ever to work. Arif Hasan, chairman of the Urban Resource Centre in Karachi, notes among several examples that the city's municipal government will not apply to army cantonment areas, which account for nearly half of the area and a fifth of the population. "They are effectively not citizens of Karachi," he says.

General Musharraf's greatest challenge, though, is to deal with religious extremism. The government fears no force more than the religious right, or so it seems. It backed away from an earlier plan to make it harder to file blasphemy charges, which carry the death penalty, for fear of a collision with the right. The diffidence is unsurprising. Successive governments have used zealots as warriors, first against the Soviet Union in Afghanistan and now against India in Kashmir. Pakistan's constitution invites the enforcement of religious norms at home. Under a court order, for example, Pakistan has a year to abolish interest from banking. Religious groups have the power to mobilise the faithful on the streets, as the curfew in Karachi showed.

The threat of zealotry

So far, their power has not been political. Religious parties rarely win seats in parliament, because they are split and because Pakistan's first-past-the-post voting system rewards the biggest parties. But political power for them some day is not unthinkable. According to Mr Gilani of Gallup, the religious parties combined have the support of about a quarter of the would-be electorate. That support normally melts away in elections, because people vote for parties that can win. But that could change if, as some expect, the government introduces proportional representation.

Pakistan will never drive Islam out of politics. General Musharraf has promised to tame the most extreme groups by disarming them and anyone else who holds illegal weapons. General Moinuddin Haider, the interior minister, boasted last month that 86,000 weapons had been turned in before an amnesty expired. He promises to "take arms from all and sundry, no exceptions made." But guesses about the number of illegal weapons, many of them kept by law-abiding folk, run into the millions.

Divorce from the extremists will come only if Pakistan makes peace with India. The hurdles, some of them on the Indian side, are innumerable. One of the highest, the army's presumed reluctance to give up its pre-eminence, may be surmountable. General Musharraf looks likely to entrench the army's role by giving formal status to the security council, which will oversee the work of the government. Mr Askari Rizvi argues that the army is now so bound into institutions and the economy that it need not depend so much on the Indian bogey. "Even with peace with India the army continues to enjoy a privileged position," he says. This year it accepted a freeze in its budget, which means a decline in real spending on defence.

Whatever happens, the army will not fade away. The government has indicated that General Musharraf means to be president for five years at least. Less clear is whether he will let Pakistan develop a workable democracy, or continue to stifle politics in the name of good government. Perhaps as president he will grasp the difference between soldiers and politicians: the former take orders from above, the latter from below.

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George Bush's troubles

In the rough

Jul 12th 2001 | WASHINGTON, DC
From The Economist print edition

AP

Can George Bush govern successfully if he isn't setting the agenda?

DURING his short political life, George Bush has thrived on a sure command of a relatively narrow political agenda. When he ran for governor of Texas, he upset a popular incumbent by focusing relentlessly on just four issues (education, tax cuts, tort reform and welfare reform). In office, he stuck to those four themes, passing laws on each of them and minimising the opportunities for legislators to consider other subjects.

Washington, DC, was always going to be harder than Austin (where the Texas legislature meets only once every two years). Mr Bush got fewer votes nationwide than Al Gore in 2000, so his mandate for any agenda is unclear. Yet, for the first few months in office, Mr Bush managed to focus relentlessly—sometimes even comically—on his campaign promises. Thus his tax cut was trumpeted as an answer first to an overheating economy, then to a sagging one and finally to higher energy prices. It sounded silly, but he got his tax cut.

But things have changed in Congress. Now that Jim Jeffords has defected from the Republicans, the legislative agenda is set—to the extent it is set by anyone—by Tom Daschle, the Democratic leader of the Senate. He has used his clout to push through a "patients' bill of rights" (a limited right to sue health-maintenance organisations). That and a campaign-finance reform bill, also passed by the Senate,will dominate the next few weeks of Congress. There is also a proposed increase in the minimum wage and a bill extending the Medicare system for retired people to cover prescription drugs.

None of these ideas comes from the White House. Except, partly, for the patients' bill of rights, Mr Bush opposes the main provisions of each proposal. Worse, they are all "Democratic issues", ones on which Americans have long trusted Democrats more than Republicans.

In contrast, Mr Bush's own "signature" issues are going nowhere in Congress. His "number one priority", education reform, has stalled. Although both chambers have passed different versions of the bill, neither has made any appointments to the conference of the two chambers that must reconcile the different versions. This paralysis has set in even though Mr Bush gave up the most controversial part of the proposal, support for school vouchers.

Worse, his "faith-based initiative" (designed to make it easier for religious organisations to get federal money for social work) has not even found a sponsor in the Senate. And hopes of a bill to reform the Social Security system soon after the president's commission reports this autumn have taken a knock

from some unwelcome news. In 2000, for the first year ever, “401(K)” private pension plans, which aim to buttress any partial privatisation of the pension system, lost money overall.

So bereft of ideas does the White House seem that officials are trying to identify “a new phase” of issues to help them regain the political initiative. At first sight, that looks like a remarkable admission of intellectual vacuousness after just six months in office; but it is not quite that bad. Mr Bush already has his big tax cut in the bag, and he should also get something out of two other bills stuck in Congress—one to loosen energy regulation, the other to reform defence.

Above all, control of the legislative agenda does not guarantee presidential success. Bill Clinton was more effective after he lost control of Congress in 1994, largely because he realised that a president has to change tactics when he is on the defensive. At this point, Mr Bush needs to do three things—and the worry for the White House is that he may be unable to do any of them very successfully.

First, you can appeal directly to voters over the heads of politicians. Ronald Reagan was a past master at this. Mr Bush is not in his league. The average of recent opinion polls shows Mr Bush’s approval ratings falling by five points since mid-April, to around 54%. That figure is passable. But the only presidents whose ratings have fallen more in their first six months were Mr Clinton and Jimmy Carter, and they didn’t have a tax cut to brag about.

One plausible explanation for this slide in the polls which may give Mr Bush some hope is that he over-compensated for what he perceived as a weakness of the Clinton administration: its continual involvement in the minutiae of public debate. In an attempt to “restore honour and dignity to the White House” (as Mr Bush put it during the campaign), the new president at first withdrew to some extent from the 24-hour news cycle. This has made him seem more remote from public life; and it has also let some bad first impressions (for instance, that he is in hock to corporate interests) remain uncorrected.

This suggests that Mr Bush simply needs to use the bully pulpit more. But can he? Mr Bush has always been best in small groups. In public, he often lacks the necessary eloquence. Asked, on Independence Day, what being president meant to him, he could think of nothing better than, “Well, it’s an unimaginable honour to be the president during the Fourth of July of this country.” Making things worse, he and his father had themselves photographed on a golf course in Kennebunkport, Maine, next to the family compound, complacently donning baseball caps saying “41” and “43” (meaning the 41st and 43rd presidents). All that was missing was a sign saying “Exclusive country club. Ordinary Americans keep out.”

And even if he can mount the pulpit, who will listen? The polls show that the decline in Mr Bush’s popularity has occurred mainly among independents or Democrats. So the small amount of headway he made after election day has been lost. America remains as evenly split as ever—which makes appealing to the country at large over the heads of his political opponents hard.

So on to the second tactic: using the presidential veto to stop laws you don’t like. Straight blocking helped Mr Clinton during his confrontations with Congress. It also produced a legislative gridlock which, by and large, benefited America, since it restrained public spending and helped pile up budget surpluses. Unfortunately for Mr Bush, the circumstances are now different.

When Mr Clinton wielded the veto, he was doing it against a Republican Congress. It was clear which side he was on. Now, with Republicans in charge of one chamber and Democrats the other, the unfortunate Mr Bush will not have the luxury of this partisan clarity.

More important, public opinion tended to support Mr Clinton on the things where he wielded the veto, so he rarely suffered any public backlash; and it also made his threats of potential vetoes more credible. Mr Bush is on the wrong side of public opinion on many of his potential vetoes. When he threatened to veto the patients’ bill of rights (just as Mr Clinton vetoed an early Republican one), it failed to turn a single vote in the Senate. In the House, Republican congressmen, nervous about next year’s election, have already voted for some energy-conservation measures Mr Bush did not deem necessary, and against a measure giving Mexican lorry-drivers American safety permits (as required under NAFTA) which he supported.

This is not disastrous. A combination of Republican control of the House and a blocking minority in the Senate may well be enough to kill some unwelcome bills before Mr Bush has to veto them. But he may not be able to use the veto weapon as often as his predecessor.

In the trenches

That leaves the third option: to give in and declare victory. This is an entirely respectable presidential strategy. Mr Bush seemed to have pulled this off with the education bill—at least at first. If he were able to sign into law, say, a watered-down education bill, plus a compromise patients' bill of rights, a campaign-finance reform package and a prescription-drug bill, he could claim to have delivered on his campaign promise to break the partisan logjam in Washington and get things done.

But of course there are dangers here too. The most obvious risk—losing conservative support on the right if he surrenders too often to Democrats—may not be all that great. His tax cut has earned him a lot of credit on the right.

Yet there is another danger. Agreeing to Democratic demands means, in almost every case, spending more money. And the economic slowdown, by reducing tax revenues and increasing spending obligations, is already cutting the budget surplus. Tax revenues are likely to be at least $50 billion below forecasts this year, and more than that next year, reducing the budget surplus from an estimated $275 billion for 2001 to $200 billion or less. That is still a healthy sum, but most of it lies in the Social Security and Medicare funds which are supposed not to be touched. The so-called "on-budget surplus" (excluding those funds) would be around $16 billion.

With congressmen currently demanding even vaster amounts of pork-barrel spending than usual (they have requested 19,000 "home-district projects" this year, worth $280 billion, most of which will not be approved), the surplus could even disappear. If it does, the Democrats will vigorously blame Mr Bush for his tax cut, even though its effect this year is modest.

In short, Mr Bush faces unwelcome choices wherever he looks. The likelihood is that some combination of the three options—a veto here, a dignified surrender there, and greater use of the bully pulpit everywhere—will prevent a disastrous decline in his power. But the Bush presidency is stuck in the trenches. It faces a long struggle, both with Congress and in its hopes of winning over public opinion.

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Punishment's purpose

Is he cured?

Jul 12th 2001 | NEW ORLEANS
From The Economist print edition

Louisiana faces up to the old question

WILBERT RIDEAU has had a pretty good career, for a man who has been locked up virtually all his adult life. As the editor of an award-winning magazine in a Louisiana prison, Mr Rideau has exposed both brutality by guards and violence among inmates. He helped to direct "The Farm", a documentary that won an Oscar nomination. *Life* magazine has called him the "most rehabilitated prisoner in America". If you believe that prisons are designed to reform criminals, perhaps Mr Rideau should be released.

AP

Rideau waits

If you believe, on the other hand, that serious crimes should carry serious penalties, then Mr Rideau may be where he belongs. Back in 1961, he was a 19-year-old high-school drop-out who robbed a bank in Calcasieu Parish, in south-west Louisiana. He took three of its employees hostage, drove them to a quiet spot and shot them. One played dead. Another escaped into the swamp. The third, a bank teller named Julia Ferguson, was begging for her life when Mr Rideau slit her throat. "He committed the most gruesome crime in this parish," says Rick Bryant, the current district attorney in Calcasieu Parish. "If he can get out, anyone can."

Now Mr Rideau may be going to trial yet again; and, if he does, Americans will get another chance to ask themselves whether criminal sanctions are designed for rehabilitation or retribution.

Although there was never much argument about his guilt, the legal proceedings that led to his imprisonment have caused a long debate. Mr Rideau is black, and his victims were white. His supporters say that racial discrimination has made it difficult for him to get a fair hearing. His two trials, which brought death sentences, were annulled. His third conviction, and his resulting imprisonment, endured for years, but in 1994 Mr Rideau appealed on the ground that blacks had been excluded from the grand jury that brought the indictment against him. A federal district judge, Frank Polozola, rejected his suit, saying that Mr Rideau had waited far too long to bring it. But last year the federal appeals court in New Orleans overturned that decision, and on June 18th the Supreme Court refused to reopen the matter.

The date for a new trial is now expected any day from Judge Polozola. It will then be up to Mr Bryant, as district attorney, to launch the case against Mr Rideau. He says he has no choice but to prosecute it: it is not his job to dispense pardons. Mr Rideau's supporters say the district attorney could drop the matter if he so wanted.

Whether to retry an ageing and celebrated prisoner may seem a tough decision. But Mr Bryant reveals no discomfort. "I can try him next week," he says, and (unlike most Louisiana district attorneys) promises to conduct the trial himself. Mr Rideau's lawyers have hinted at a deal in which their client will plead guilty and be sentenced to the amount of time he has already served. But guilty of what? Mr Bryant says any conviction on a murder charge would carry a sentence of life imprisonment or death, and that he will not agree to charge Mr Rideau with the lesser crime of manslaughter.

Mr Rideau's supporters say he has already been in jail far longer than most murderers; and releasing him would be good for peace in prisons. "When you build prisons and provide no hope," says George Kendall, one of Mr Rideau's lawyers, those inside "are very hard to manage."

Yet letting any convicted criminal back on to the streets has long been close to political suicide in Louisiana. Because of its high crime rates, this state has more than its fair share of people whose lives

have been harmed by crime; and many are convinced that sending people to prison was the main reason why crime everywhere dropped so sharply in the 1990s.

The get-tough-at-all-costs line is not as popular as it was. Louisiana's legislators recently approved a bill to cut prison sentences for some drug offences and other non-violent crimes. But, if Mr Rideau wants to be freed, he will still have to rely on judges and juries ready to temper horror with mercy—and with the hope that the horror will not happen again.

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Transport in Washington state

Going nowhere

Jul 12th 2001 | SEATTLE
From The Economist print edition

And certainly not fast

EACH day, Sally del Fierro and a neighbour share a car into Seattle, 26 miles from where they live. Even in the lanes reserved for cars with two or more occupants, the drive generally takes more than an hour. In bad weather, or if an accident blocks part of Interstate 5, it takes two hours. In the three years that Ms del Fierro has been making the journey, the traffic has become noticeably worse. Moreover, 600 new houses are planned for her town, each of which will dump another car or two on narrow local roads.

AP

Uneasy riders

A report in May from the Texas Transportation Institute, which keeps an eye on such things, confirmed that Seattle has the second-worst traffic in the country, equal with Atlanta and just behind Los Angeles. Commuters in the area lose 53 hours a year stuck in traffic over and above their normal commuting times, burning 81 gallons (307 litres) of petrol while their cars idle away. Businesses find it increasingly difficult to move supplies and people from one place to another.

What to do? A light-rail system for Seattle, which at present relies largely on overworked buses for public transport, has been in the works since 1993. But, without a single spadeful of earth turned, the project is $1 billion over budget and years behind schedule. A citizens' initiative passed in 1999 lopped $2 billion from the state transport budget by limiting fees levied on vehicle licence-plates. A sharp earthquake in February complicated matters by weakening a freeway viaduct along the Seattle waterfront; it almost certainly needs replacing, at a probable cost of $600m. And there are scores of rickety roads and bridges all across the state.

When the state legislature convenes on July 16th for its fourth session this year, its chief task will be to vote on a $17 billion package proposed by Gary Locke, the Democratic governor, that is designed to improve the state's roads as well as its rail service and its extensive ferry system. But winning approval will not be easy. The lower house is evenly divided, 49-49, with neither side willing to approve anything for which opponents might take credit. The state Senate is on the whole readier to spend big money on transport. But politicians from eastern Washington—where a storm on June 26th caused huge damage to cherry and apple crops—are reluctant to raise constituents' taxes to help fuming motorists in Seattle.

Mr Locke, an able but low-key technocrat, has been pushing his package hard, working on lobbyists and touring the state to muster support. But even he is reluctant to admit what everyone knows—that improving transport will require an increase in the state petrol tax. (European readers may insert bitter laughter here—a gallon of gasoline in Washington costs a trifling $1.60.) Anyway, both Mr Locke and the legislators seem inclined to let the voters choose for themselves what they want to build or not build, rather than take a risk by deciding on their behalf.

The irony, notes David Olson of the University of Washington, is that the state was once a leader in almost every form of transport. Roads, railways and ports figure prominently in the region's early history, as the first settlers fought against their geographical isolation. Shipping to Alaska made Seattle rich in the 1890s. William Boeing left a career in timber to go into aviation, and never looked back. Seattle's port was among the first in the country to be publicly owned.

In recent years, however, transport has been seen as a necessary evil. Voters abhor gas taxes and tollways, and local towns bitterly resist proposals to enlarge nearby freeways. A proposal to add a third runway at Seattle-Tacoma International Airport has resulted in 12 years of lawsuits and disputes. The

reason for this change of heart is the region's economic success. The region's new techno-elite is less interested in building roads than in preserving nice, green views from its windows.

Only a big recession, Mr Olson thinks, is likely to make these people change their minds. So far the area's technology firms have been rather less clobbered by their industry's slump than their peers in Silicon Valley—a fact to which the roads around Redmond, full of commuting Microsoft programmers, bear ample witness.

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Water and the energy crisis

You say potato, I say electricity

Jul 12th 2001 | MOUNTAIN HOME, IDAHO
From The Economist print edition

Should western water flow to spud farmers or to hydroelectric dams?

IDAHO potatoes blend 21st-century technology with 19th-century political muscle. The technology makes Idaho's potato-growers among the most productive farmers in the world; in August, from a mere 400,000 acres, they will pull 20 billion pounds (9 billion kilos) of potatoes. That is up from 12 billion pounds 20 years ago. It is 30% of the total American output, and enough to give 3lb of spuds to every human being on the planet.

Unfortunately, people do not want that many potatoes. So Idaho farmers have a problem. Across southern Idaho and the eastern portions of Oregon and Washington state, 4.8 billion pounds of potatoes sit in warehouses, virtually worthless. Farmers can expect to get little more than $2 for a 100lb bag that costs perhaps $4 to produce.

Potatoes, no matter how unprofitable, need water for irrigation and for processing into the French fries that sit next to Big Macs worldwide. Water has been contentious in Idaho ever since fist-fights broke out along the first irrigation ditches more than 100 years ago. Nowadays, the potato farmers' water is protected by an intricate dam of law and tradition that shields long-standing water users and has its own strange rules about how water is used, often in direct contravention of both economic and environmental good sense.

A farmer, for instance, can give up using his water for a year or two. But, if that becomes five years, he has to surrender the rights to the water. And much of the water is provided at rates well below market value. Rather than conserving water, there is thus a powerful incentive to keep using it regardless of whether the crop that uses it has any value. "This is an ingrained, legally protected pathology," says Ray Huffaker, an expert on water law at Washington State University in the farming-country town of Pullman. The argument about whether the West's economy would be better served by transferring water from farmers who create little value to cities that create a lot (and are prepared to pay for the water) is an old one. And by the absurd standards of western agriculture—eg, the miracle that allows Californian farmers to grow alfalfa and rice in a near-desert—Idaho's potato farmers are not particular transgressors. But this year they are in the firing line.

One reason is that this summer may be the West's driest in 50 years. The other is to do with electricity and geography. The potato farmers draw their water from rivers like the Columbia and the Snake, whose dams (lower down-river) supply much of the West's hydroelectric power. This year, with consumers in many western states facing power cuts, that water, and the electricity it produces, are desperately needed.

Other troubled industries have already turned the power crisis to their advantage. Aluminium producers, for instance, have cut production in order to sell electrical power that is too valuable to use for smelting aluminium. But the idea of selling their water to the power companies meets stony resistance from the potato farmers.

It is not just that they are being difficult. Water is fiendishly difficult to manage. It is a "fugitive" resource, meaning it has a tendency to wander away—unlike, say, a stand of trees. And water use has a domino effect: draw water from a stream, and landowners 100 miles downstream feel the impact. Then there is the huge capital investment in the canal systems, farm equipment and processing plants that

have grown up around the potato industry.

There is a human side, too. Take Mike Wing, a 39-year-old farmer who lives with his family near Mountain Home, Idaho. He has been a farmer for 11 years, growing potatoes, alfalfa and sugar beet on his 5,600-acre spread. A passer-by might think Mr Wing is doing fine. There is new equipment on the well-tended property. Mr Wing pumps around $3m a year into running the farm. But his return is maybe $100,000 in a good year. “Not many investors would stand for that,” he admits. He holds on so that he can be his own boss, and work the land.

This year, though, Mr Wing is not farming. Idaho Power is paying him to do nothing. The water not used to water Mr Wing’s crops is generating power, and the farmer is earning enough from the deal to take a year off, studying at nearby Boise State University. Next year he plans to be farming at full speed again, partly in order to preserve his water rights.

The trading mirage

This is a long way from the sort of water trading that most economists recommend. Mr Huffaker suggests a “contingent market”, in which farmers sign contracts with power generators or other water users to sell a fixed amount of their water rights during low-flow years. In doing so, they would not abandon their water rights; but it would make trading easier.

At the moment, such ideas draw frosty looks. Yet the fact that they can be heard at all shows that the water-rights system is creaking. In southern Oregon farmers have been cut off from 80% of the water they normally receive in order to protect migrating salmon, which get federal protection. Farmers are appalled that voters should favour a fish’s sex life over their future. Still, if Americans decide they prefer fishing or inexpensive power to cheap French fries, there should surely be a market to let them make the choice.

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Lexington

Secrets, lies and hubris

Jul 12th 2001
From The Economist print edition

If nothing else, the Condit case reveals the arrogance of power

THREE years ago, the only thing Washington could talk about was the relationship between a politician and a Californian intern. Now America has a new president who came into office determined to raise the tone of politics in the nation's capital. And still the only thing Washington can talk about is the relationship between a politician and a Californian intern.

Which would all be very amusing, in a "Groundhog Day" sort of way, if it were not for the fact that the intern at the heart of the current gabfest is probably dead—and probably murdered. Missing people do not usually turn up 11 weeks after they disappear; and suicides do not dispose of their bodies so that nobody can find them. As Karl Marx could have said, history repeats itself, the first time as farce, the second as tragedy.

The two leading actors in the tragedy are Chandra Levy, a 24-year-old intern in the Federal Bureau of Prisons, and Gary Condit, a 53-year-old congressman who represents Ms Levy's home district. Ms Levy arrived in Washington from Modesto last September, one of the small army of bushy-tailed young people who come to the city in order to learn how the government works. Mr Condit, a seven-term Democrat, is best known for his blow-dried good looks (he appeared as Mr June in the "Hunks of the House" calendar) and his habit of riding a Harley-Davidson. His wife, who is said to be ill, seldom comes to Washington.

Ms Levy has not been seen since April 30th. Her behaviour before her disappearance hardly suggested that she was on the verge of killing herself. She made a number of routine preparations for her imminent return to California, cancelling her membership of the local gym and e-mailing her parents about her travel plans. The police found partly-packed suitcases and her wallet and credit cards in her apartment. Mr Condit was one of several people who was questioned about Ms Levy's whereabouts. For more than two months he maintained that he and the intern were just "good friends". On July 6th he at last admitted that they had been having an affair.

The result is the perfect Washington summer story, not only involving an infatuated young woman and a lascivious congressman who is "not a suspect" but also echoing the Lewinsky affair. Ms Levy, too, is the daughter of a Californian cancer doctor. She also confessed details of her affair to a confidante. The Levy family's lawyer once represented Monica's mother. One investigator described Mr Condit's answers as "Clintonesque".

But it is a perfect Washington story in a more profound way: because of what it reveals about the way the city works. It demonstrates the casual hubris of the powerful, and also shows what extraordinary methods ordinary people have to adopt if they are to combat the dissimulation of an insider.

For what else besides hubris can explain the congressman's behaviour? He conducted an affair with an impressionable young woman entirely on his own terms. When they went out for dinner together, for example, Ms Levy had to commandeer a cab, and Mr Condit ducked in a few minutes later, his face hidden under a baseball cap. And when she disappeared, he put his own reputation above everything else. He not only failed to come clean with the police about the nature of their relationship; he even bamboozled his own staff into lying on his behalf.

Such hubris hardly makes Mr Condit unique in Washington. Who knows how many congressmen have enjoyed flings with their interns and then lied about it to “protect their families”? Bill Clinton not only lied about his relationship with Ms Lewinsky; he used the White House spin machine to discredit people who tried to tell the truth. Republicans such as Newt Gingrich and Bob Livingston have also behaved caddishly. Yet, even by these low standards, Mr Condit comes across as distressingly selfish. After all, in this case the police were engaged in a missing-person investigation in which every day and every scrap of information might make the difference between life and death.

The Condit affair is not just depressing for what it tells us about the sort of people who rise to the top. It is also depressing because it shows how hard they are to confront. Politicians are powerful people, and the local police are not very competent. (The *Washington Post* recently observed: “Thugs bent on murder will find no more hospitable place in which to take a human life—and to kill again—than the nation’s capital.”)

Balance of power

Just as Mr Clinton’s rubbishing of “that woman” might well have succeeded but for one (inexplicably uncleaned) dress, Mr Condit would have got away with his behaviour had the Levy family not decided to play hardball. Exasperated by the police dithering and Mr Condit’s stonewalling, they hired Billy Martin, a savvy Washington lawyer, and Porter Novelli, a high-powered public-relations firm. And they mounted a carefully planned campaign to persuade the public that Mr Condit had secrets to hide (which he may have done: he also had an affair with an air hostess and allegedly one with an 18-year-old from Modesto).

The Levys have prodded the police into belatedly searching Mr Condit’s apartment. But still nobody knows what happened to Ms Levy. And there is a downside to hardball justice. Mr Condit has inevitably hired a team of lawyers and spin doctors of his own; and America’s television screens are filled, night after night, with representatives of the rival teams, hurling accusations and splitting hairs. It would be hard to think of a better recipe for reinforcing public cynicism about Washington.

During the Lewinsky affair Mr Condit told the president that “you can’t get to closing this issue without getting all the information out there,” adding that “the fact is the information is going to get out eventually, anyway.” If Mr Condit had heeded his own advice, he would have saved two families from a great deal of unnecessary pain. And he might have saved American politics from another unnecessary drubbing.

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South America's economies

A gathering twilight

Jul 12th 2001 | SAO PAULO
From The Economist print edition

AP

Argentina's intensifying problems are causing difficulties for its neighbours, spreading pessimism across the region

"HOW much spending can you cut without sacking anyone? Answers on my desk in 48 hours." This was the challenge that Argentina's President Fernando de la Rua set his ministers on July 10th. Had it come four months ago, his show of determination to get the government's finances under control might have reassured investors. Now it looks too late: later that day, they demanded interest rates of 14% in an auction of three-month treasury bills, up from 9% last month, and showed no appetite for longer-dated bonds.

Domingo Cavallo, the economy minister, admitted that Argentina could not go on paying such high interest rates, or its situation would "worsen geometrically". Only last month he thought he had won a breathing-space by swapping short-term bonds worth $29.5 billion for longer-term ones. Now the renewed fear that Argentina will default on its debts is sending a shudder of fear through financial markets across South America—and beyond. Investors have dumped emerging-market shares, bonds and currencies in a flight to safer assets. Brazil's *real* and Chile's peso plunged to new lows against the dollar; even Mexico's strong peso weakened.

Argentina's troubles are not the only reason for pessimism. Brazil, the region's largest economy, has its own problems. And the slowdown in the United States' economy has staunched the flow of direct investment by its firms in Latin America—recently an important source of finance and growth in the region. Foreign investment in Brazil, the region's largest economy, is likely to be only $20 billion this year, down from $33 billion last year.

Not long ago Brazil was worrying about growing too fast and hitting capacity constraints. Now it faces a slowdown. Industrial production has been falling since April, partly because of electricity shortages. The Central Bank has raised interest rates four times since March, and intervened in the currency market, but all to no avail: the *real* has lost almost a quarter of its value so far this year.

Since much of Brazil's public debt is pegged either to interest rates or to the dollar, the rise in both means its debt burden has increased (see chart). President Fernando Henrique Cardoso hinted this week that he might extend the life of the country's agreement with the IMF, which expires in December. Even so, Brazil faces difficult choices if the currency continues to weaken. The Central Bank has spent about $1 billion on buying *reais* in the

past three weeks. Reserves are only $11 billion above the minimum agreed on with the IMF. Selling more dollar-linked bonds might increase Brazil's debt burden. Further rises in interest rates, recommended by some economists, would also add to the debt.

A better option might be even tighter fiscal policy. The government is committed to a primary (ie, before interest payments) fiscal surplus of 3% of GDP for the next three years. But to stop the ratio of debt to GDP from rising, Brazil needs a primary surplus of at least 4% of GDP, reckons Marcelo Mesquita of UBS Warburg, an investment bank.

Why not simply let the currency fall? The Central Bank insists it no longer has an exchange-rate target. But it does have an inflation target, of 2-6% this year. The weak *real* means that inflation is already threatening to burst through the ceiling. But, as Marcelo Carvalho of J.P.Morgan Chase, points out, changes in the interest rate take up to nine months to affect inflation, and by next year Brazil's economy and its inflation rate will have slowed markedly.

In Chile, the star economic performer in Latin America in the 1990s, the authorities face a slightly different dilemma. The central bank there has already cut interest rates five times this year, to try to stimulate a flagging economy. But domestic demand has remained weak, while Chile's exports are starting to suffer from the slowdown in the United States. With inflation under control, the economy would benefit from further interest-rate cuts—were it not for the peso's weakness.

Such problems would seem minor if Argentina were to default. Mr Cardoso's officials were said this week to be preparing for that, even as the president himself was publicly expressing his "absolute certainty" that Argentina would pull through, and guaranteeing Brazil's full support.

For all Mr Cavallo's frenetic efforts, there are still no signs that Argentina is pulling out of recession. Doubts remain, too, as to whether President Fernando de la Rua's governing coalition has any appetite for Mr Cavallo's last-ditch call for fiscal frugality. "We have to go immediately to a zero deficit," he told bankers on July 11th. In particular, Mr Cavallo wants to reform the social-security and health agencies.

With congressional and provincial elections due in October, such reforms are unpalatable. Raul Alfonsin, a former president and the leader of Mr de la Rua's Radical Party, recently called for higher social spending. But although public spending cuts would intensify Argentina's recession, they would still be less painful than the increasingly threatening alternative of default and devaluation and a flight of capital from the entire region.

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Canadian politics

Lost leaders

Jul 12th 2001 | OTTAWA
From The Economist print edition

The right-wing opposition is a mess

Get article background

IF CANADA's ruling Liberals are once again living up to their nickname of "perpetual governing party", that has less to do with the qualities of Jean Chrétien's government than with the shambolic state of the right-wing opposition. Last year the opposition seemed to be on the up, when Reform, a party strong in western Canada, linked up with some members of the Progressive Conservative Party to form a new party, the Canadian Alliance, under a new leader, Stockwell Day. But that was when the problems began.

For the past three months, the Alliance's 66 MPs have fought a public war over whether to dump Mr Day. On July 7th, a year to the day after he was chosen as leader, the Alliance's executive called for him to resign. Mr Day's response seemed only to make matters worse. He offered to take a "leave of absence" from the leadership until a party convention scheduled for April 2002, but only if he could name his temporary replacement. Not surprisingly, Mr Day's main critics, a group of 13 MPs who have left the Alliance's official caucus in Parliament, rejected this condition. So Mr Day withdrew his offer. He remains the leader, but a wounded one.

What has gone wrong? In his brief period as a federal politician, Mr Day has been extraordinarily accident-prone. He was chosen as leader because he spoke French and seemed to be charismatic: he enjoyed being photographed showing off his skills as a kickboxer and roller-blader. But, coming from Alberta's provincial government, where he had faced a tiny opposition, he lacked political experience.

The hope was that Mr Day would break the Liberals' hold on Ontario's 103 parliamentary seats. He failed. When Mr Chrétien called a snap election last November, the Alliance boosted Reform's previous tally by 764,000 votes and six seats. But it won only two seats in Ontario.

It has been downhill ever since for Mr Day. A fiscal conservative, he passed on the bill for a lost libel suit to Alberta's taxpayers. He dropped his party's proposals for a flat tax and publicly repudiated his party's policy on refugees, both without consulting colleagues. More even than most politicians, he blames staff members or the media for his own mistakes. He denied (but then had to admit) that he had met a part-time spy to discuss gathering dirt on the Liberals. And so on.

In the latest opinion poll, support for the Alliance has sunk to 10%, from a peak of 28% last October. More defections among MPs seem likely; already two among the nine members of the national executive have resigned over Mr Day's failure to quit. By contrast, the rump of the Progressive Conservatives has twitched into life. Led by Joe Clark, a former prime minister, the Conservatives won only 12 MPs last year, but now stand at 21% in the opinion polls. Mr Clark has made overtures to dissident Alliance MPs. But he has rejected any serious merger talks while the Alliance is in turmoil.

Mr Clark has problems of his own. Two successive Conservative Party presidents have resigned since September, complaining of Mr Clark's authoritarianism. And he is disliked by most Alliance members. Sooner or later, the two parties will merge. But first they must find a new leader.

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Colombia

Gold and goals

Jul 12th 2001 | BOGOTA
From The Economist print edition

Money revives the Copa America

LAST-MINUTE improvisation is a Latin American fault, and virtue. But this is ridiculous. A fortnight ago, after much agonising, the South American football confederation (CSF) called off the Copa America, a tournament involving the region's national teams, on security grounds. A week later, just six days before it was due to start, the CSF decided the Copa should go ahead after all. It duly kicked off with a game between Chile and Ecuador on July 11th. Only Argentina, currently the region's best team, and Canada dropped out, though Brazil brought its own police guard.

Reuters

Now they can cheer

The trepidation was triggered by a wave of bombings in Colombia's cities in May. Then, last month, a tournament official was kidnapped for 48 hours, seemingly by the FARC guerrillas. That broke the CSF's nerve. So its volte-face is a triumph for Latin America's football passion? No. It is a sign that capitalism rules, even in South American football. Traffic, a Brazilian company that had sold television rights and sponsorship (to Coca-Cola, MasterCard and Telefonica) said it would sue the CSF for $50m over the postponement.

Colombians are euphoric, having escaped the embarrassment of not holding the Copa. At least 20,000 extra police are on duty, along with marksmen and bomb experts. It is now for the country's various armed factions to decide whether Colombia will still be celebrating after the final in a fortnight's time, regardless of whether its team makes it.

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Augusto Pinochet

He's demented

Jul 12th 2001 | SANTIAGO
From The Economist print edition

Pinochet escapes trial—but is not quite found innocent

Get article background

ALMOST three years after General Augusto Pinochet was arrested in London at the request of a Spanish judge, the attempt to bring Chile's former dictator to book for the crimes of his dictatorship has finally run into the sand. On July 9th a panel of three Appeals Court judges ruled by two to one that the general was "demented" and thus unable to defend himself in a trial. That angered the families of those murdered by the dictatorship, but also denied General Pinochet the dignified exit from public life that he craved.

The ruling applies to only one case, that involving the "death caravan", a group of military officers who murdered political prisoners after the 1973 military coup, and whom the prosecution alleges were acting on General Pinochet's orders. But it will be applied more widely. It means that the former dictator is unlikely to face trial on more than 300 other cases that have been brought against him in Chile, or be extradited to Argentina, where he is wanted for questioning by a judge investigating the assassination in 1974 of his predecessor as army commander.

Prosecution lawyers may appeal. Oddly, the Appeals Court based its judgment partly on a procedural change to Chile's penal code that has yet to take effect in Santiago. But the substance of its ruling is unlikely to be changed. In theory, too, proceedings against General Pinochet could be revived if his health were to improve. But that is equally unlikely. He suffers from a long list of ailments, including diabetes, high blood pressure and a heart complaint. He recently spent six days in Santiago's military hospital.

The ruling saves the general from the humiliation of having his fingerprints and police mugshot taken. That should have been done when charges were brought in January. His lawyers achieved repeated postponements on health grounds. But the judgment also denies the ex-dictator the chance to clear his name and means that, even if his health allows, he cannot return to Chile's Senate, in which he had awarded himself a seat for life.

Despite its anti-climactic denouement, the Pinochet case has changed Chile, nudging forward a still-incomplete transition to democracy and breathing a new zeal for human rights into the judiciary. Other cases will continue through the courts, including that in which five former army officers have been charged in connection with the "death caravan".

Most Chileans had tired of the Pinochet legal saga. They are more worried about unemployment and the economy. Neither the centre-left government nor the conservative opposition wanted it to continue. Both saw it as a distraction ahead of a congressional election in December.

Prosecution lawyers blamed political pressure for the suspension of the case. The outcome does amount to special treatment, since Chilean justice normally makes little allowance for age or ill health. Ironically, in explaining its ruling the court cited international human-rights conventions. The verdict may lead to a flood of appeals from other elderly or infirm defendants. It will be strange if General Pinochet turns out to have unwittingly promoted a more liberal criminal-justice regime.

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Jamaica's riots

Burning

Jul 12th 2001
From The Economist print edition

Behind the violence lie drugs and political competition

ROTTING bodies, bloated by the tropical sun, lay in the streets of Kingston this week, as soldiers patrolled the deathly-quiet streets of Jamaica's capital after an outbreak of violence on the island had left 25 people dead. At the self-contained tourist resorts on the north coast, scuba-diving classes carried on as normal. But Jamaicans are worried about what the world will think. Some fear that worse may be to come in the approach to an election which must be held by December 2002.

AP

The army clears the streets

The trouble started on July 7th, when a gun battle that lasted 24 hours broke out between police and the residents of Tivoli Gardens, a central district of Kingston and the political stronghold of Eddie Seaga, a former prime minister and the leader of the opposition Jamaica Labour Party (JLP). Businesses closed, buses stopped and roadblocks were thrown up across city streets and in some rural areas. P.J. Patterson, the prime minister, responded by calling out the army and imposing a curfew.

Violence is nothing new in Jamaica. Between January and June, in an island of 2.6m people, there were almost 500 murders, 60 more than in the first half of 2000. Riots are also common. They are an extension of politics. Since the 1970s, both the JLP and Mr Patterson's People's National Party (PNP) have had close links to inner-city criminal gangs. Each party has its "garrison constituencies", where gang leaders (known as Dons) flash gold teeth and get rich through cocaine deals and protection rackets. Their links with politicians are sometimes open. When Willie Moore, a gang leader, was killed in April, the finance minister turned up for the funeral, along with two cabinet colleagues.

The prime minister's spokesman claimed that the violence was "orchestrated" by the JLP to force an early election. But the opposition accuses the government of using the police to attack its strongholds to discredit it. The JLP is 16 points ahead in the opinion polls, and won a by-election in March. The government, in power since 1989, looks tired. The economy is barely scrabbling back to growth after a slump from 1996 to 1999.

In fact, the violence this time may have had more mundane causes. The shooting was set off by a police raid for weapons. Its intensity probably owed as much to turf wars between rival drug gangs as to political rivalry. "The political culture in Jamaica has now reached the stage where incidents of gang warfare are turned to political advantage," says Anthony Bryan, a Caribbean specialist at the University of Miami.

The likelihood is that Kingston will be back to normal by next week. And although there are some tough areas in towns such as Montego Bay and Ocho Rios, they have never seen serious violence. Both Britain and the United States this week told their citizens not to cancel holiday plans, but to avoid trouble spots.

Tony Blair, Britain's prime minister, will be taking his own government's advice. He plans to meet Mr Patterson on July 29th on a one-day visit to Jamaica, part of a trip with main stops in Mexico and Brazil. One of his engagements is to attend the final of a football tournament for youngsters from Kingston's warring neighbourhoods, set up by Prince Charles on a visit to the island last year. Jamaicans will hope that rivalries will be confined to the football field in future.

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Trials in Cambodia

Better late than never

Jul 12th 2001 | PHNOM PENH
From The Economist print edition

A tribunal to investigate Khmer Rouge crimes takes shape

AP

Crying out for justice

THE estimated 1.7m victims of the Pol Pot regime that ruled Cambodia from 1975 to 1979, as well as those who managed to survive the Khmer Rouge "killing fields", may yet win a measure of justice. After months of haggling over details, the National Assembly at last passed legislation this week that will enable a special tribunal to shed light on the darkest chapter in Cambodian history.

Khmer Rouge defendants will not be dragged off, like Yugoslavia's Slobodan Milosevic, to a fully-fledged United Nations tribunal at The Hague. Instead they will stand trial in the Cambodian capital, Phnom Penh, before a court supported by the UN but presided over by both Cambodian and UN-appointed judges. China, the main backer of the Pol Pot regime, had always made clear that it would veto any Security Council resolution to create a UN tribunal for Cambodia.

It has taken two years for the UN's legal experts and the government of Hun Sen to agree on a framework for the new court. Some UN lawyers and human-rights organisations still claim that its complex provisions fall short of international standards. Cambodian judges, who have minimal legal training (only seven lawyers survived Pol Pot's slaughter) and are not known either for their independence or for their grasp of the finer points of international law, will enjoy a three-to-two majority at each trial, and a four-to-three majority in the tribunal's special court of appeal. However, according to the tribunal's rules, at least one international judge must be party to any majority ruling.

The legislation still has to pass the Senate and be approved by King Norodom Sihanouk. After that it will be scrutinised by the UN too. There could yet be sticking-points. Mr Hun Sen has frequently accused the UN of trying to dictate the terms of co-operation, thus souring relations with a UN legal team in New York that often seems out of touch with Cambodian political and cultural sensitivities.

Mr Hun Sen was formerly a dissident junior officer who led resistance to the Pol Pot regime in 1977. He has never forgiven the UN for its continued recognition of the Khmer Rouge regime during the 1980s, when he and many others were calling for a tribunal.

Two senior Khmer Rouge figures are already in military custody, and another six are lying low but could be picked up at any time, including Ieng Sary, Pol Pot's former foreign minister. Controversially, the king has already pardoned him for genocide, though other charges could still be brought. Yet, three years after defeating the last remnants of the Khmer Rouge insurgency, and with Pol Pot himself now dead, Mr Hun Sen is more interested in peace and reconciliation. He is therefore unlikely to rush to arrest more suspects.

The Cambodian model—assuming that it works and proves it is able to carry out its task both cheaply and efficiently—could influence the way the UN handles future tribunals. A similar framework is already being talked about for Sierra Leone. For Cambodians, after more than 20 years of delay, the new tribunal is almost certainly their last and best chance to obtain a measure of justice.

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Bangladesh

Politics as normal

Jul 12th 2001
From The Economist print edition

Bombing, feuding, spending—and then going to the polls

WITH a general election expected in October, Sheikh Hasina Wajed is likely to become the first prime minister in the coup-steeped history of Bangladesh to serve out her full term of office. Nevertheless, the period of her rule has been stained by violence which many fear will continue as the election campaigning intensifies. One attack was the bombing of an office of the governing Awami League, which killed 22 people in June. The attackers have not been found, although the government has routinely blamed Muslim fundamentalists and the opposition Bangladesh Nationalist Party (BNP).

AP

Sheikh Hasina heads for the polls

Some Bangladeshis have even suggested, without any evidence, that the government itself could have been behind the violence to win the sympathy of voters and foreign donors. The donors are indeed concerned about how Bangladesh spends the more than $1 billion that it receives in foreign aid each year. The country was said to be the most corrupt of more than 90 countries in a recent survey by a Berlin-based non-governmental organisation, Transparency International.

One of the last laws passed under Sheikh Hasina's government has given her and her sister special security arrangements for life. Fifteen people accused of involvement in a plot to assassinate her last year are on trial. Some of those convicted of murdering her father, Bangladesh's independence leader, Sheikh Mujibur Rahman, in a coup in 1975 remain at large, and Sheikh Hasina's supporters allege they could threaten her. Others said to be involved were sentenced to death after the Awami League's 1996 election victory over the BNP, ending 21 years in opposition. The BNP has demanded similar security for its leader, Khaleda Zia, herself the widow of an assassinated military leader.

The issue has become intensely personal, as have previous issues between the two women who dominate Bangladeshi politics. But, like many political questions hotly debated in the capital, Dhaka, and other cities, this one may hold little interest for the vast majority of Bangladesh's 130m people, most of whom live in villages. Two-thirds of Bangladeshis can barely afford enough to eat, and they are likely to vote on local issues and personalities. Much of Bangladeshi society is still struggling to emerge from feudalism.

There is little to choose ideologically between the two main political parties, except that the Awami League is more pro-Indian, while the BNP favours Pakistan and counts small Islamic groups among its allies. Pessimism among those who take a broad view of Bangladesh's problems appears to be shared by the Asian Development Bank. It has warned the government that the budget deficit of 6% in the most recent fiscal year will deepen this year. The ADB renewed the donors' long-standing appeal to the government to solve some of its economic problems by exporting natural gas, an expedient that has so far been prevented by politics. To her credit, Sheikh Hasina has relieved the gloom a little by negotiating a fragile peace with tribal rebels in the south-eastern Chittagong Hill Tracts and a water-sharing treaty with India. Despite recent border clashes, the Indian government hopes the Awami League will be returned to power.

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Gas in India and Pakistan

A pipe of peace?

Jul 12th 2001 | DELHI
From The Economist print edition

India and Pakistan hope to agree on a pipeline

PIPING in cheap gas from Iran could solve many of India's pressing energy problems. There is a slight geographical problem, however: the pipeline would have to go through Pakistan, giving India's principal foe a choke-hold on its energy supplies. The very idea provokes nightmares for Indian security experts, who have opposed the idea for a decade. Yet agreement on building such a pipeline—or at least, on conducting a joint feasibility study for one—might be one of the few tangible achievements to emerge from this weekend's meeting in Agra between General Pervez Musharraf, the president of Pakistan, and Atal Behari Vajpayee, India's prime minister.

Long-term projections suggest that India's demand for gas may increase from 74m cubic metres a day now to 322m a day by 2025. Enormous quantities of cheap gas are available in Iran and Qatar. But, at the moment, transporting it to India is prohibitively expensive. One option is to liquefy the gas and ship it, but calculations suggest that the price of the fuel, once it had been regasified in India, would increase eight-fold. An onshore pipeline across Pakistan, say optimists, could cut that in half.

A third option, long favoured by India's security experts, would be a sea pipeline from the Gulf to India, bypassing Pakistan's territorial waters. But such a pipeline could cost as much as $5 billion, against a little over $3 billion for the onshore version. Nor would an offshore pipeline be inviolable: it could be hit by submarines or depth charges. Besides, repairing leaks is far more difficult and expensive offshore than onshore.

However, after a visit to Iran in April, Mr Vajpayee seems to think that the onshore option may be feasible after all. Iran is keen on selling gas to India, and has already commissioned BHP, an Australian company, to do a feasibility study for an onshore pipeline and Snamprogetti, of Italy, to study the offshore option. The Pakistani risk could, perhaps, be diminished if a consortium of multinationals were to build and operate the pipeline, backed by transit guarantees from Pakistan. Besides, the pipeline might yield Pakistan anything from $250m to $600m a year in transit fees, depending on the volume of gas. The country is deep in foreign debt, and would have a strong incentive to keep the tap open.

But some Indians fear that even this would not be a guarantee of Pakistani compliance. Instead, they would like an agreement whereby the gas pipeline would fuel a huge power plant in India that would also supply electricity to Pakistan, maybe to a big city like Lahore. With that, any disruption of the gas supply by Pakistan would mean a blackout for Lahore as well.

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Malaysia

Mahathir's anniversary blues

Jul 12th 2001 | KUALA LUMPUR
From The Economist print edition

After 20 years in power, can anything persuade the strongman to step down?

Get article background

A LESSER autocrat would be slinking towards the exit by now. Mahathir Mohamad is beset by crumbling support among the Malay majority, growing disaffection within the Chinese ethnic minority and sporadic, but nonetheless shocking, public criticism from a handful of judges and respected members of his own party, the United Malays National Organisation (UMNO). Moreover, an economy that is slowing sharply, without having recovered from a collapse three years ago, will add to Dr Mahathir's worries in the coming months.

Yet, as he prepares to celebrate 20 years as prime minister on July 16th, Asia's longest-serving elected ruler is voicing doubts about everyone but himself. In a rare understatement last week, the 75-year-old Dr Mahathir neatly summed up his opponents'—and some would say his country's—enduring burden: "I'm afraid they'll find it difficult to get rid of me."

This, it must be noted, is at odds with the official line. Dr Mahathir has suggested several times in the past few years that he will relinquish power before the next general election, due by 2004. These occasional musings helped him to shore up support among wavering Malays before the last general election, in 1999, and again in the approach to party elections last year. Dr Mahathir has also begun speaking of the deputy prime minister, Abdullah Badawi, as his eventual successor, breaking a previous habit of dismissing his deputy as ill-prepared. The forces driving these concessions are likely to grow more compelling over the next couple of years. So does Dr Mahathir really believe that he can defy his detractors and win another term as prime minister?

Malaysia's political system is designed to help him do so. But for the first time since independence in 1957, UMNO may find it hard to fend off democratic pressure for change. Although its coalition won a two-thirds majority in parliament in 1999, it sustained an unprecedented loss of supporters at its base. Some turned to the Islamic party, PAS, which increased its hold on the north-eastern state of Kelantan and gained control of its neighbour Terengganu. It seems unlikely that PAS's aim of eventually governing Malaysia could be realised; the Malaysians are too fond of their material comforts to embrace Islamic austerity. All the same, PAS offers a powerful message to the voters: it has been demonstrably honest in the states it controls, and so far has been moderate in imposing the ways of Islam. At the next general election, UMNO will face 650,000 new voters in an electorate of 10m. Many of them are young people who have been outraged by Dr Mahathir's monopoly of power and by stories of corruption in his administration. Even the prime minister has given warning that an opposition victory might be "no longer that difficult".

Although dissidents have been complaining loudly for the past few years, Dr Mahathir's vulnerability may also start to embolden those with stronger links to the establishment, increasing calls within UMNO for him to step down. He has already faced several legal setbacks in the past few months, surprising many observers. A High Court judge recently ordered the release of two dissidents who had been jailed under the Internal Security Act, chastising police in the process and voicing doubts about whether Malaysia needed such a draconian law.

None of this seems to have weakened Dr Mahathir's fondness for his favourite tactics. Despite the release

of some dissidents, five of the ten opposition activists who were arrested under the security act in April remain in jail. Last week two students were arrested under the act. In another action to show his strength, Dr Mahathir has recently taken over the finance ministry from his long-time ally, Daim Zainuddin. Although officially Mr Daim has resigned to take a well-earned rest, Dr Mahathir's three previous deputy prime ministers could be forgiven for detecting a pattern. Over the past two decades, whenever he has looked shaky, he has jettisoned a close ally and carried on.

That is why, for all the apparent momentum building against him, it is too soon to begin counting the days until Dr Mahathir yields power. Opponents and pundits have been forecasting his demise for the past few years, analysing one big event after another for signs that his end is near. More high drama will no doubt surround a state election in Sarawak, which must be called this year. Towards the end of the year, the first post-Daim budget can be expected to prompt questions about how long Dr Mahathir's pump-priming can sustain him.

Yet it is still impossible to predict which way his large ego will lead him. The recent bluster may indeed be a prelude to resignation—a show of confidence to convince everyone that he is leaving on his own terms. Perhaps one more anniversary in office, or independence-day celebration, or fiscal package, really will be all that Dr Mahathir needs to declare victory and become autocrat emeritus.

Despite all the recent dissent, the prime minister still retains huge powers with which to suppress any real criticism. And after watching so many other autocrats lose power—such as Suharto in next-door Indonesia—Dr Mahathir may yet conclude that it is best to hang on indefinitely. Otherwise, he may one day have to hear what other Malaysians really think of him.

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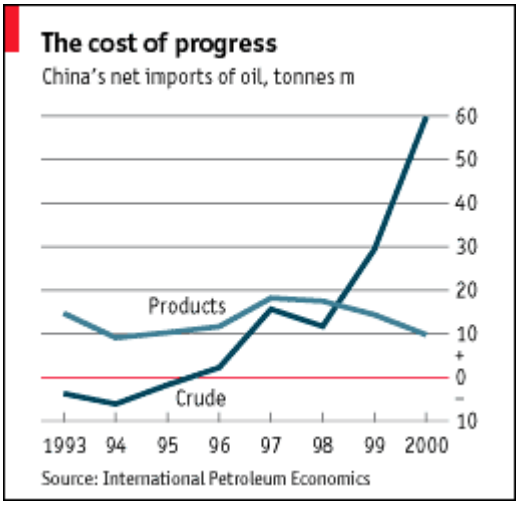
China's oil

Taken hostage

Jul 12th 2001 | BEIJING
From The Economist print edition

China needs a strategic oil reserve

WITH no stored-up supplies to speak of, and evidently fearing either a sudden price rise or a disruption of supplies coming in by sea, China has become spooked by its dependence on imported oil. Although its plans are for a piffling reserve of only 6m tonnes (44m barrels), the equivalent of a month's imports, achieving it seems likely to tax the abilities and resources of China's energy bureaucracy to the full.



In the early 1990s, as China's economic growth began to surge, hopes were high that new oil discoveries in China, particularly in the far-western region of Xinjiang, would prevent over-reliance on imports. But Xinjiang failed to deliver as expected, and the OPEC oil-production cuts of 1999, which led to a price surge, concentrated senior minds on the urgency of the problem. At the annual session of China's parliament in March, the government said it would work to establish a reserve within the next five years. At the end of June, it got as far as revealing how big it would be.

The past few years have come as a rude awakening for the world's sixth-biggest oil producer. Long gone are the glory days of 1963, when China became self-sufficient in oil. Last year China's net crude imports were a record 60m tonnes—more than twice as much as in 1999. Officials predict that by 2010 it will need to import 120m tonnes a year (roughly the same as South Korea's current imports), and nearly double that amount (exceeding Japan's current imports) by 2020. By then, China will depend on imports for over 50% of its oil consumption. But many China-watchers say this is a very conservative forecast, and the International Energy Agency (IEA) predicts that China's net oil imports will be as much as 400m tonnes a year by 2020.

Even taking the conservative figures, the outlook is gloomy enough for those concerned about oil security. More than half of China's imports come by ship from the Middle East. The fastest route is via the narrow Malacca Strait, which could easily be blocked by an enemy. The potential enemy that China worries about most is the United States, and relations with that country have become as prone to sudden fluctuations as world oil prices. Shipping in the Malacca Strait also faces a threat from increasingly well-organised piracy.

But setting up a strategic reserve will require a lot of money and a lot of help from China's not-so-eager oil companies. By China's (probably conservative) estimates, it would cost about $2.5 billion to set up a 6m-tonne reserve, including storage and transport. This assumes that oil costs an average of $20 a barrel during the period when the stockpile is accumulated ($20 a barrel was the average for the past five years, compared with $27 today). And this is just the beginning. A senior government analyst, quoted last week by *China Daily*, an official newspaper, said that China ought to increase its strategic oil reserve to 15m tonnes by 2010. This would still be well below the equivalent of 90 days' imports that the 26 mostly western countries of the IEA hold or have pledged to hold in their reserves.

The government wants the oil companies to help share the burden. But China's oil industry has changed dramatically since the late 1990s, when the government decided to create two giant oil companies modelled on western lines in order to make the industry more competitive. These companies were listed abroad last year. They complain that they would find it difficult to explain to shareholders why they

should spend money on stockpiles they do not need. To help them, the government is offering tax incentives and cheap loans. But as *China Daily* put it, “a specific programme is still trapped in the bureaucratic machinery.”

China is also looking at a number of other ways to enhance its oil security. These include investing more in oil exploration and production in different places abroad, importing oil by pipeline, finding alternative fuels, developing futures trading and using energy more efficiently. But military security is high on the leadership’s mind. A strategic oil reserve would provide a visible deterrent to any potential enemy that might consider China’s economy incapable of sustaining conflict. “It’s like a nuclear bomb,” a senior government researcher, Chen Huai, argued last month in the Beijing-based *Economic Observer*. “Once you’ve made it, it acts as a kind of intimidation.”

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Indonesia

He isn't going quietly

Jul 12th 2001
From The Economist print edition

President Abdurrahman Wahid raises the stakes

WITH less than three weeks to go before he is due to be unceremoniously dumped by Indonesia's sovereign assembly, President Abdurrahman Wahid's behaviour is growing steadily more erratic. This week he was at his worst. Though he has several times in the past talked of declaring a state of emergency if his enemies persist in their—perfectly constitutional—attempt to remove him from office on August 1st, the president has now raised the stakes by setting a deadline of July 20th for the impeachment motion to be withdrawn. If it is not, he says, he will not only declare an emergency but dissolve parliament and call fresh elections.

Reuters

The bluster continues

Mr Wahid's problem is that no one appears to be listening. The army has repeatedly said that it will not enforce a state of emergency, and neither will the police. Mr Wahid's response has been to replace his security minister and to attempt to replace his top policeman. Though the army man obliged, General Bimantoro, head of Indonesia's police, has refused to accept his sacking which, according to the rules, must be approved by parliament. On July 12th Mr Wahid ordered General Bimantoro's arrest: rather a futile gesture, since the general is reported to have decamped to Singapore for a convenient medical check-up. The attempt, however, is a further example of Mr Wahid's tendency to ignore the proper procedures.

So far, all this looks farcical rather than really dangerous. Controlling as he does only 10% of parliament's seats, and having lost the loyalty of the security services, it is hard to see how Mr Wahid imagines he can survive. All the main parties bar his own have united against him to condemn his record in office and to call for the August 1st special session of the People's Consultative Assembly, which appointed Mr Wahid in October 1999 and has the power to dismiss him.

But it is equally clear that Mr Wahid is not, at least not yet, contemplating a dignified exit. The real fear is that he will decide, as he has often threatened, to take his struggle to the streets, calling on his supporters in the 40m-strong Nahdlatul Ulama, Indonesia's largest Muslim group, to protect him. The NU has been relatively restrained as the president's impeachment has progressed. But will he be responsible enough to keep it that way?

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Iran and its oil

The fight over letting foreigners into Iran's oilfields

Jul 12th 2001 | TEHRAN
From The Economist print edition

The minister selling Iranian oil deals is not honoured in his own country

TOLD to increase oil production, but prevented by sanctions from doing business with American firms, Bijan Zanganeh, Iran's oil minister, has spent the past four years trying to do business with European and Far Eastern companies. Recently, he has had some success: he has now won deals that could add an extra 700,000 barrels of oil every day to the 3.7m barrels a day currently produced in Iran. Twice in the past two weeks, by signing agreements with Italian and Japanese companies, he has exposed the futility of American efforts to dissuade non-American companies from investing in Iran's energy. Yet Mr Zanganeh remains unloved at home. Protection-minded compatriots claim he is handing a vital resource to untrustworthy foreigners, and a senior cleric promises to expose corrupt energy deals.

Mr Zanganeh has fallen victim to his country's sensitivity to foreign involvement in its energy. A quarter of a century after America and Britain teamed up to topple an Iranian prime minister who had dared nationalise the Anglo-Iranian Oil Company, the 1979 Islamic revolution sought to redeem things. By outlawing the granting of mineral concessions to outsiders, the new regime boosted national pride at the cost of foreign expertise, technology and finance. Output plummeted.

By 1997, when Mr Zanganeh became minister in Muhammad Khatami's government, the need was for a way around the restrictions. The minister developed an unorthodox kind of oil deal: the buy-back. The name is a misnomer: nothing is bought or sold, but foreign oil companies are paid a fee for exploring and developing fields. The constitution prevents them from having a stake in production.

It was an uphill struggle, with both Iranians and the oil companies suspicious of what they were being offered. Two years earlier, Bill Clinton had banned virtually all American business with Iran. Non-American oil companies were wary of a deal that offered fixed returns, but kept production the reserve of the National Iranian Oil Company (NIOC), headed by Mr Zanganeh. Moreover, at least to begin with, the companies were afraid that Mr Clinton would use a controversial right, conferred by Congress, to punish non-American companies investing in Iranian energy. Then, when it became clear that he would not use this right and some deals were signed, many Iranians considered them too generous to the oil companies.

The value of foreign deals signed to date now approaches a respectable $15 billion. On June 30th the minister and Italy's ENI company signed a $920m deal to develop the Darkhovin oilfield. Eight days later, the minister signed a preliminary agreement with a Japanese consortium to explore the much larger Azadegan field.

The ENI deal was a considerable achievement for Mr Zanganeh, with negotiations conducted in the teeth of fierce opposition within the NIOC itself. For the deal illustrates how the buy-back concept can evolve. By allowing Italian engineers a "monitoring" role once the oil begins to flow, the ENI contract gives foreigners an unprecedented say in production. It also links remuneration to performance. According to one foreign oil executive, it represents the first step in a journey that may eventually lead to conventional production-sharing agreements.

So it was probably not by coincidence that a conservative ayatollah, Ahmad Jannati, chose July 1st, the

day after the ENI deal was struck, to announce that he knew the names of “those inside the oil empires who plunder millions and millions and send them to their own foreign bank accounts.” A close associate of Ayatollah Ali Khamenei, Iran’s supreme leader, Mr Jannati opposes Mr Khatami’s policy of cautious liberalisation. Only last month the Council of Guardians, the upper house that he heads, vetoed legislation designed to attract foreign investment.

The buy-back negotiations have indeed been pretty murky. The ENI deal is the first whose terms have not been kept hidden. It is not exactly true, as the minister has implied, that dozens of qualified and virtuous people check the minutiae of every deal: three deputies are entitled to learn their gist, once the bargaining is over.

Mr Jannati’s comments, though reflecting a general antipathy towards foreign oil companies, were also directed at a domestic audience. In the past few weeks several conservative newspapers have been asking why Petro Pars, a private Iranian oil company that Mr Zanganeh helped to set up, had been awarded contracts worth at least $5.5 billion, especially since Petro Pars lacked expertise, and had subcontracted many of its projects to foreign companies.

For the answer, conservatives point to Petro Pars’s chairman, Behzad Nabavi. Mr Nabavi is an old friend of Mr Zanganeh. He is also a reformist deputy, said to be interested in the job of vice-president. Mr Zanganeh’s allies argue that co-operation between Petro Pars and foreign companies will give rise to an essential transfer of technology. Others look askance. “If there is corruption,” says Ali Hashemi, a former deputy oil minister, “it lies in the subcontracting.” Should conservatives prove that the reform movement is being financed by kickbacks, the damage will reach far.

That is some way off. Mr Jannati has yet to carry out his threat to hand over his “names” to the judiciary. On July 9th Mr Khatami called the accusations propaganda. In the meantime, the buy-backs continue and within a few weeks Mr Zanganeh will probably sign another deal, similar to the ENI one, with Spain’s Sepsa.

All in all, the apparent intention of America’s Congress to renew the Iran-Libya Sanctions Act when it lapses next month looks pretty silly—unless, of course, President George Bush, unlike his predecessor, is willing to risk a trade war by enforcing secondary sanctions. Moreover, though Mr Bush gave his approval in March to the renewal of America’s own sanctions against Iran, he is said to be toying with the idea of lifting his country’s objections to Iran’s application for membership of the World Trade Organisation. This looks a bit contradictory. The closer Iran gets to WTO norms, the more foreign oil firms will do business with it. Apart from American ones, of course.

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Israel's Palestinians

Post-mortem on Black October

Jul 12th 2001 | GALILEE
From The Economist print edition

Uncomfortable findings from the inquiry into the internal intifada

NINE months after Israel's 1m or so Palestinian citizens briefly joined the *intifada*, their towns and villages are quiet. Their mood is not. "All of Israel now recognises us as a problem for the Jewish state," says Ameer Makhoul, a Palestinian leader.

EPA

A non-Jewish problem for the Jewish state

Liberal Israelis believe that the remedy is investment, plus job and other preferment to redress the chronic discrimination that Israel's Palestinians suffer in every public sphere. Less liberal ones, including many people now in the government, see the source of the problem as a latent nationalism that the *intifada* rekindled—and are determined to snuff it out.

In recent months, Palestinian politicians have been detained without charge, writers have been questioned by intelligence officers about their "extremist nationalist" writings, and the police have recommended that Azmi Bishara, a radical member of the Knesset from the Arab-nationalist Balad movement, should be tried for sedition. In June he made a speech in Syria calling on Arabs to "resist" Ariel Sharon's government. He also applauded the "heroic example" of Hizbullah.

These may not have been the brightest comments to make. But Mr Bishara said nothing in Syria that he has not also said on the floor of the Knesset. There is also the matter of parliamentary immunity. And at a time when Jewish Knesset members are calling Yasser Arafat "a murderer" and questioning whether Israel's Arab citizens should have the vote, the police's recommendation suggests double standards.

Those double standards are being examined by an official commission of inquiry into the violent events last October, the "internal" Palestinian *intifada*. The commission was reluctantly set up by Ehud Barak's government, and is now into its seventh week of public hearings."Black October" was perhaps the bloodiest confrontation between the state and its Palestinian minority in Israel's 53-year history: in the demonstrations, 13 Palestinians were killed and 1,000 sent to hospital.

The commission's recommendations "may or may not be accepted," says Uzi Landau, Israel's public-security minister. The minister's discomfort arises from the evidence the commission is hearing about the behaviour of his police. The line of the last Israeli government, from Mr Barak down, was that the police had used only rubber bullets in the October clashes. The commission has swiftly put paid to that fiction. It has unearthed the government's own autopsies to prove that at least two of the 13 victims were killed by conventional ammunition (and that, suspiciously, only four autopsies were carried out).

It has also found that police snipers were authorised to fire conventional bullets from rooftops at protesting boys and young men armed with slingshots. For Israel's Palestinian public, this sounds perilously close to a shoot-to-kill policy. It quashes the previous government's defence that the police shot only in "life- endangering" situations.

Above all, the commission has exposed the disparity in government policy towards its Jewish and its Arab citizens. Against Palestinian protesters, the police were given "a green light to do whatever is needed" (as Mr Barak put it in an interview on Israeli radio on October 2nd). Yet when faced with a 3,000-strong Jewish mob torching mosques and attacking Arab shops in Tiberias, the police's orders were to "leave their guns in their cars".

In the long run, says Hassan Jabareen, whose legal centre unofficially represents the victims' families, the hearings will educate Israeli Jews as to what the Israeli Palestinians' struggle is now about. It is not, he insists, for separate sovereignty, as many Jews fear. But neither any longer is it just for the civil equality that was long promised by successive governments but never honoured. After Black October, he says, "the Palestinian struggle inside Israel is for a new definition of citizenship that recognises us as a national minority."

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Small arms

Big damage

Jul 12th 2001
From The Economist print edition

A UN conference is trying to control a most dangerous trade

FEW people would disagree with the aim of reducing the illicit trade in small arms and light weapons. Even though small arms are responsible for up to 90% of the casualties in armed conflicts, no international framework exists through which to end the illegal trade in them. This is what a United Nations conference, which opened in New York this week, is trying to promote.

AP

A name on every bullet

Trying is the word. At this stage, the best it can probably hope for is a political document vague enough to secure broad support from the delegations taking part. Although most countries agree in principle on the need to curb illicit trade in small arms, there is no shortage of contentious issues. Outlining the scope of the exercise is a political landmine in itself. America has already made it clear that firearms such as pistols and hunting rifles, and anything that interferes with the legal right of Americans to carry guns, are off-limits.

Protecting the legal trade in small arms is also high on the agenda of the main producing countries. According to the Small Arms Survey, a research group based in Geneva, illegal transactions, worth about $1 billion a year, account for 10-20% of the global trade in small arms. The vast majority of small arms in circulation are held legally by soldiers, the police or private owners. Many illegally traded arms first come to market as a result of legitimate deals. It is the later transactions that are so difficult to track and control.

Where national armaments laws exist, they tend to deal with the production and export of arms but often fail to regulate private broking. Since the illicit trade in such weapons recognises no borders, controlling it requires co-operation between goverments. Data collecting and sharing would be a good start. Of the 60 countries involved in legal export, fewer than 30 provide any public information on their small-arms sales. Regional initiatives, which have cropped up in Latin America, Europe and Africa, as well as the legally binding Firearms Protocol adopted by the UN General Assembly last May (which deals exclusively with the trafficking of firearms involved in organised crime), could provide the elements of a comprehensive international framework.

The value of these initiatives, however, is only as good as their monitoring and enforcement. Heart-warming as it is to know that West African countries have committed themselves to a moratorium on the import, export and manufacture of light weapons, reports of repeated breaches of the embargo in Sierra Leone and Liberia discredit the exercise. Yet exposing culprits sometimes works. Since the publication of a detailed UN report on embargo violations in Angola's civil war, Bulgaria, which used to be a big source of illegal weapons, has cleaned up its act.

What can the small-arms industry itself do about illicit trading? Can it, for instance, follow the diamond industry's example in fighting the illegal trading of "conflict" diamonds—those from war zones? It would be difficult. For one thing, the prospect of a consumer boycott, instrumental in enlisting the diamond industry's co-operation, is not something small-arms suppliers have to worry about. Moreover, unlike the diamond market, the small-arms industry is highly competitive and fragmented. Though the size of the industry has declined both in volume and value, the number of legal manufacturers has tripled from fewer than 200 firms in 1980 to more than 600 today, spread among 95 countries. Distribution is even more fragmented, as private arms-brokers have flocked to organise covert arms deals since the end of

the cold war. Without a De Beers leaning on the suppliers, the chances of enforcing stricter discipline in the small-arms industry are slim.

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Zimbabwe

Normal times in an abnormal country

Jul 12th 2001 | HARARE
From The Economist print edition

The government's violent ways of preparing for next year's election

THE country has returned to normal after the two-day strike that more or less shut it down at the beginning of the month. But what passes for normal in Zimbabwe these days is pretty weird. Cars, queuing for petrol, snake slowly through the cities, Robert Mugabe's supporters threaten factories with violence and army units beat up people in Harare's townships. Farm occupations continue (more than 5,000 farms, representing over 90% of all white-owned farms, have now been designated for seizure), and farm owners and their workers continue to be attacked. Opposition activists are beaten, murdered or sometimes just disappear.

The strike was ostensibly a protest at the government's decision to raise the price of fuel by 73%. It was also a huge demonstration of the public's feelings towards Mr Mugabe and his regime. The question being asked everywhere is "How can we get rid of Mugabe?"

With difficulty, is the answer. The strike, though successful in bringing everything to a stop, highlighted the limits of this sort of action: the regime was not directly threatened by workers staying home for two days. Now the Zimbabwe Congress of Trade Unions says it will give the government one last chance to negotiate the fuel-price rise. If it does not respond favourably, say the unions, they will go on indefinite strike for a "final onslaught". Yet it seems highly improbable that the labour movement will be able to muster the strength to bring the government down.

The main opposition party, the Movement for Democratic Change (MDC), is criticised for not having a strategy to topple the regime. Comparing Zimbabwe to Serbia, dissidents speculate whether the Mugabe era could not be brought to an end by massing people in the streets of Harare as people were massed in the streets of Belgrade last year. But first there have to be elections. The MDC is determined that change should come about through constitutional means. The opposition has fixed its sights on the presidential election, due in April 2002, as the chance to defeat Mr Mugabe and restore democracy.

Mr Mugabe, too, has begun campaigning for the election. His "war veterans" roam cities and farms, meting out violence to anyone viewed as opposition. His police chief says he will dismiss any officer who backs the opposition. The intimidation of the MDC has increased, with raids, based on spurious charges, on homes and offices of opposition members of parliament. An MDC official, Paul Themba Nyathi, was forced off the road this week in what looked like an assassination attempt disguised as a car accident.

Yet the MDC believes that, even with government fraud at the polls, it can still defeat Mr Mugabe next year. Morgan Tsvangirai, the party's president, has called on the outside world to take steps now to support his country's democracy. Pointing out that the campaign period is as crucial as the actual vote, he has called for the extensive deployment of foreign observers, both for the presidential poll and for parliamentary by-elections.

The opposition also recognises the need for voter-education programmes to assure people, especially in the countryside, that the vote is secret. But the government finds this idea so threatening that it has given warning that it will ban any church groups or non-governmental organisations from carrying out civic-education campaigns.

Another pre-election issue is food relief. At last admitting that it will have to import food, the government has sent messages to potential donors that it will need relief—blaming droughts and floods, not, of course, its own disastrous agricultural policies. But the MDC is calling for all relief to be distributed by non-governmental organisations to prevent the ruling ZANU-PF party from using food as a campaign tool.

Other Zimbabweans are looking further ahead. Human-rights workers are grimly compiling dossiers on beatings, torture, murder and disappearances in the hope that, once Mr Mugabe and his henchmen are voted out of power, they may find themselves standing trial.

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South Africa

Space invaders

Jul 12th 2001 | KEMPTON PARK, JOHANNESBURG
From The Economist print edition

A land-grab in South Africa raises the spectre of invasions, as in Zimbabwe

WOMEN stamped and danced; men held up hammers and saws, shouting, “This is the land for the people.” On scrubland near Johannesburg’s international airport, demonstrators, led by the opposition Pan Africanist Congress (PAC), defied the police by claiming “a new phase of our revolutionary actions”.

By last weekend over 5,000 squatters had hammered together shacks for a new would-be township. South Africans, living in overcrowded city slums, are desperate for space to call their own. Some people had been camping on the scrubland for months, but most had arrived just a few days earlier, to stand in long queues to buy useless “receipts”, sold for 25 rand ($3) by the PAC. “With this small piece of paper I can hopefully find some land here,” explained one deluded buyer.

The rand plunged as investors worried that Zimbabwean land-grabs, and attacks on farmers, had crossed the border. The government is determined to show that things are different in South Africa, as indeed they are. “We cannot allow people to wake up in the morning and just come and take land. This is not the new Zimbabwe, not at all,” said Steve Tshwete, the minister of security, on July 3rd. Both President Thabo Mbeki and his land-affairs minister, Thoko Didiza, spoke publicly about the need for the rule of law and for orderly land reform. On July 10th the government obtained a court order to evict the squatters within 48 hours, and said it would do so by force, if necessary.

But there is fear that the Johannesburg example could be copied in other parts of the country. “If we do not handle this quite firmly, it will spread like a veld-fire,” said Nic Opperman of the farmers’ Agricultural Union. For their part, the PAC’s leaders declared last week, to great cheers from the squatters, that they would support similar actions elsewhere.

Across South Africa white farmers, already vulnerable to criminal attack, patrol their farms and shoot trespassers. Dozens of farmers have been killed in the past year, as have many black people who enter farms unannounced. The police arrested 19 squatters who occupied land on a farm earlier this year in Eastern Cape province. In KwaZulu-Natal, a dispute over land owned by the mixed-race descendants of a Scottish settler has led to annual arson attacks on their fields of sugar cane.

Almost everyone agrees that the time has come for urgent land reform. One of the most powerful means of white control during the apartheid years was to dispossess black people of their land. Today, even many of the people who benefited from this, such as the Afrikanerbond (a successor to the Broederbond, a Boer secret brotherhood), want to see it reversed.

But the government’s three-pronged efforts—restitution, redistribution and tenure-reform—have been only partly successful. The most sensitive part of the programme is the return of land to those who can show that they previously owned it. According to the National Land Commission, which recently gave warning of Zimbabwe-style land occupation if reform were not speeded up, restitution is only now beginning to show results. In June 1999, only 41 restitution claims had been settled, through the return of land, financial compensation, or both. By the end of last month, the figure had risen to more than 12,000.

A broader sharing out of land, and reforms to the land-tenure law, are even slower to get going. Although big landowners are beginning to realise that they must cede some productive land, whether others can show a legal claim to it or not, almost none has been passed on as yet.

Bureaucracy, lack of political interest and limited funds have meant that the government’s policy of acquiring farms on a willing-buyer, willing-seller basis has produced no noticeable change. Perhaps the

latest events—in Zimbabwe, and in Johannesburg last week—may stir everyone to move a bit quicker.

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About sponsorship

France's official sleaze

Gather round the trough

Jul 12th 2001 | PARIS
From The Economist print edition

President Jacques Chirac (below) is in trouble over his use of money of dubious origin. Why isn't Lionel Jospin (on the left) whipping it up?

Get article background

FIGHTER aircraft streak in formation across the Paris sky; martial bands bring a tear to the patriotic eye; troops parade down the Champs Elysées in choreographed appeal to national pride. How fine, then, to be Jacques Chirac, president of France, and to take the salute on July 14th, the anniversary of that day in 1789 when angry Parisians stormed the Bastille prison and sparked off the revolution. What an opportunity to remind the nation of the republican ideals—liberty, equality and human rights—that France has ever since preached as universal. In short, with the next presidential election less than a year away, Bastille Day provides the perfect opportunity to look presidential, and therefore worthy to be re-elected.

So why have the clouds gathered this year over Mr Chirac's parade? Why are some politicians on the right, ostensibly his allies, muttering that he will lose to Lionel Jospin, the Socialist prime minister? Why do a few even muse that Mr Chirac may not put himself on the ballot paper?

The answer is that he faces an ever-rising tide of scandal. Over the past year Mr Chirac's name has been linked to illegal kickbacks on public-works contracts, the illicit financing of political parties, phoney jobs for party members and, in a burst of headlines last month, the use of taxpayers' cash—literally, since airline tickets and hotel bills were paid for with bank-notes—to buy foreign trips for himself and his family. This week France's now-relentless investigating judges began questioning former aides to the president, including his influential daughter, Claude, about the jaunts abroad. Next week they will, it is said, grill his wife. All that prevents the president himself being interrogated, even if only as a witness, is a lawyers' stalemate. The president's men invoke the constitution to say a president in office is above such things. The Paris prosecutor last week begged to disagree, but was this week contradicted by his superior on the Paris appeals court.

Lawyers being lawyers, this wrangling will probably go as far as the supreme court, and may last beyond next spring's presidential and parliamentary elections. Yet in any other western democracy, says Alain Madelin, leader of the free-market Liberal Democrats (and a declared candidate for the presidency), the president would long ago have been toppled.

So how does Mr Chirac survive? In part because the French public has long considered politicians corrupt by definition, so what's new? And the public has a point, witness the now notorious scandals of François Mitterrand's presidency. As for Mr Chirac's alleged misbehaviour, it dates from his 18-year tenure as mayor of Paris, from 1977 to 1995, when the public-works kickbacks were apparently divided between all the main political parties, including even the Communists. Last December, in a denial of any personal

involvement, the president, describing himself as the “permanent victim” of scurrilous speculation, argued that it was the system of party financing that was at fault, and that he had been the first to introduce rules to clean it up. Let the French be reassured: there was and is no “moral or political crisis”.

Maybe not. But does the argument apply to the FFr2.4m ($450,000 at the time) paid in cash for foreign trips by the Chirac entourage between 1992 and 1995? The conservative *Le Figaro* this week put the total only half that high, but that answers no questions. Why in cash? Where did it come from? The bland presidential explanation is that payments in cash were a way of preserving security and that the money was partly from Mr Chirac’s own pocket, partly from “secret funds” legally acquired during his time as prime minister—four years or more earlier. His opponents hint at a different explanation: perhaps the money came not from the special funds but from the public-works kickbacks—and, either way, it was clearly being spent for his own purposes, not even for his party, the Rally for the Republic.

Yet at least one opponent, the prime minister, thinks the best tactic is to tread carefully. Rather than support some left-wing efforts to remove the president’s immunity forthwith, Mr Jospin says any constitutional amendment to that effect should come into force only with the next presidency. As to the secret funds, set up over 50 years ago and totalling FFr394m for this year, they have their place, he thinks: just over half goes to run the secret services, the rest being shared between the presidency and the prime minister’s office to boost (in crisp cash) the pay packets of the supposedly overworked and underpaid, from senior ministerial advisers down to secretaries and cooks.

Indeed, when three conservative parliamentarians, noting that governments of both left and right have benefited from the money, this week demanded an immediate freeze on the funds, Mr Jospin accused them of blatantly and irresponsibly trying to divert public attention: “Why not”, he asked, “freeze the state?” The better way, says Mr Jospin, is to review the system with a careful parliamentary inquiry. He does not mean one of the deep-digging American variety.

The electoral question is whether Mr Jospin’s softly-softly approach will bring him victory. In theory it sets him above the tawdry goings-on of daily politics (indeed, it makes him look presidential), while leaving Mr Chirac’s reputation to be stained by every new leak from the judiciary. Yet he cannot be sure. The left too—from the Socialists through to the Communists—has plenty of skeletons to keep hidden from the judges. And Mr Jospin was for years first secretary of the Socialist Party, and later a minister, under the dubious President Mitterrand.

Meanwhile, Mr Chirac remains remarkably popular. Even as pollsters declare that 80% of French adults are “shocked” by the way the secret funds have been used, they also find that in the second round of a presidential election, when all the no-hopers have been knocked out, Mr Chirac and Mr Jospin look to be neck-and-neck.

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The EU's next six months

We have ways of making you talk

Jul 12th 2001 | BRUSSELS
From The Economist print edition

The Belgians, that is, now in the European Union's chair

THERE is a children's game called "King for the day", in which a lucky infant is allowed to boss everybody else around for that space of time. The European Union's version of this is called "president for six months". Every six months a fresh one of the 15 EU countries is allowed to set the EU's agenda and to chair all its meetings. This rotating presidency does little to create continuity of policy or wider public appreciation of what the EU is all about. But it is politically necessary, and rather jolly for the country concerned.

Belgium, which is chairing the EU from now until the end of the year, is lucky enough to have taken over at an exciting time. On January 1st next year the euro, the EU's new single currency, will at last appear as notes and coins. The next six months will also be a decisive period for the negotiations aimed at bringing into the EU most of the countries of East and Central Europe, negotiations which the EU has promised it will try to conclude by the end of next year. And Belgium's presidency will culminate with a summit in the Belgian town of Laeken on December 14th and 15th, at which the EU will embark on another round of political and constitutional reforms.

It is the Laeken summit that seems to excite the Belgians most. They have always been keen integrationists. Laeken is their opportunity to give a fresh push to the notion of the "ever-closer union" that the EU's founding fathers dreamed of.

At Laeken, the EU's national leaders will set up a political convention to consider its future. The members of the convention will be largely drawn from the European Commission, national governments, national parliaments and the European Parliament. The summit will ask them to consider a broad range of questions. For example, should the EU write itself a constitution? What should be the division of powers between the Union, its constituent countries and European regions? Should it seek its own tax-raising powers (see article)? The Belgians want to appoint some elder EU-statesman to chair the convention. Much of the haggling at Laeken may centre on who exactly this pivotal figure will be.

The fact that so much can already be safely predicted about Laeken is an indication of why the six-month presidency can be important. For the Belgians want to push through a much broader agenda than the more cautious countries—Britain, Ireland, the Nordics—would have liked. The British at first wanted the next round of EU political haggling to be very limited in scope, and they opposed the whole idea of a convention. Now they have accepted both ideas. In return, Tony Blair has extracted a promise from Guy Verhofstadt, his Belgian counterpart, that when the convention reports in 2003 or 2004 it will not come up with a take-it-or-leave-it blueprint, but will instead offer a series of options for national leaders to consider.

The Belgians have agreed to this idea, partly because they think it may ultimately play into the integrationists' hands. If the convention had to agree on a single text, they reason, it would probably come down to the lowest common denominator of the rival ideas. A broader range of options may allow the more integrationist ideas to gather support.

On the enlargement of the EU, the Belgians insist that they are just as keen as the Swedes, who made it a central theme of their presidency in the first half of this year. But Belgium has asked the European Commission to issue a report not just on how much EU-related legislation the would-be members are enacting, but on the quality of their implementation of law and their administration. Fair questions—but ones that the applicants are bound to see as an attempt to slow things down.

As for the euro, most of the technical preparations are in the hands of the European Central Bank. But

even here the Belgian presidency has a role. Indeed, differences over how to handle the preparations have already strained relations between Wim Duisenberg, head of the ECB, and Didier Reynders, Belgium's finance minister. Between them, they had better get it right. The euro matters to the average EU citizen. For Laeken or enlargement talks, he doesn't give a tuppenny damn.

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An EU tax?

The citizens will love it

Jul 12th 2001 | BRUSSELS
From The Economist print edition

A few enthusiasts want a special EU tax, to make the EU more popular

FOR a while, the idea seemed to be gathering support. At present, about 14% of the European Union's budget of *euro*93 billion ($86 billion) comes from customs duties; the rest, on formulae beyond most human understanding, from national treasuries. But recently, with varying degrees of enthusiasm, a number of European grandees have come out for, or at least for looking at, a switch to a specifically EU tax. Among those in favour have been Romano Prodi, the head of the European Commission; Hans Eichel, Germany's finance minister; Laurent Fabius, his French counterpart; and the prime ministers of Belgium and Luxembourg. The European Parliament's budget committee too is in favour, and reckons the parliament should set the tax rate.

The Belgians are among the most vociferous supporters. They argue that an overtly EU tax would make the EU's workings easier to examine, and therefore—a large leap of reasoning, this—more popular. Of course, they add hastily, any such new tax would have to be offset by matching tax cuts elsewhere.

What sort of tax should this be? The Belgians have floated a number of options: a defined share of national value-added-tax receipts; an EU-wide tax on savings; one on e-commerce; an energy tax. Strangely, a direct EU income tax is not on the list.

Alas, the more EU leaders have thought about the idea, the less they like it. In a rare public session of Ecofin, the grouping of European finance ministers, most of them ridiculed the idea and, by implication, Didier Reynders, Belgium's finance minister. Gerrit Zalm, the Dutch one, said that the last foreigner who had tried to impose a tax on his people, the Duke of Alba, a 16th-century Spanish governor-general, had provoked an 80-year war. Britain's moneyman, Gordon Brown, recalled the tax on tea that led to the American revolution. Chastened, Mr Reynders said he would press ahead with his idea, but would try to ensure it did not cause "a war in the Netherlands or a revolution in the United Kingdom". Need he bother? Any decision would have to be unanimous and ratified by all national parliaments.

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German labour law

No great harm, no good either

Jul 12th 2001 | BERLIN
From The Economist print edition

That's Chancellor Gerhard Schröder's record in this field

THE central plank of Gerhard Schröder's election campaign in 1998 was his promise to bring down unemployment from the 4.1m that it stood at then to under 3.5m by the next general election, due in the autumn of 2002. Now, with just over a year to go and the economy unlikely to grow by more than 1% this year, according to the latest forecast from the Berlin-based German Institute for Economic Research (DIW), that pledge looks hard to redeem, if not impossible. The number of jobless, which had been coming down steadily for three years, has been rising again for the past six months. It now stands at 3.85m. And by now it is the voters' chief concern. No wonder the chancellor is beginning to quake in his shoes.

The labour office isn't short of work

As he should, many would say. Despite repeated warnings from international organisations and Germany's own economic research institutes, the government has done little to relax the notorious rigidities of Germany's labour market. Indeed, many of the measures it has introduced appear to go in precisely the opposite direction: strengthening works councils, extending the right to part-time jobs, limiting the maximum duration of fixed-term contracts, increasing sickness benefit (and so making "sickness" more attractive), imposing tax and welfare charges on low-paid jobs, and giving back job protection to workers in firms of five-to-ten workers.

Yet, despite the employers' predictable squeals, there is actually little evidence that this has done any significant harm. "Some measures may have made things marginally worse, others marginally better," says Klaus Zimmermann, head of the DIW. "But our studies show that the overall effect has probably been neutral. So far, Mr Schröder has relied on macroeconomic conditions to bring unemployment down. And these are no longer enough. But he has neither worsened labour-market flexibility, nor improved it."

To be fair, the government has brought in some bold reforms. It has cut the (all-inclusive) tax rate on corporate profits from 52% to 38%. It has abolished capital-gains tax when one company sells its holding in another, so encouraging greater efficiency. It has chopped the top rate of income tax from 53% to 48%, and plans to bring it down to 42% by 2005. It has introduced an element of state-subsidised private financing for the first time into Germany's tottering pension system, and has promised to keep state-pension contributions below 20% of gross wages for the next couple of decades. And it is now planning contentious legislation to admit tens of thousands of foreign workers, to help relieve bottlenecks in the economy caused by growing shortages of certain skills.

This year alone tax cuts have lopped over 1% of GDP off company and household tax bills. But the hoped-for boost to domestic demand was negated by an unexpectedly sharp rise in inflation. This hit a 12-month 3.5% in May, and is still above 3%. The unions are already sharpening their swords.

In what was considered one of the few real successes of the government-brokered "Alliance for Jobs" forum linking employers and unions, most wage settlements agreed on last year covered a two-year period, with moderate rises averaging 2.5% a year. At that time, inflation stood at a mere 1.5% and was expected to be no higher this year. With inflation now double that, the unions feel they have been duped. The huge 28% rise just won by Lufthansa's pilots has added to their annoyance.

The next big round of wage negotiations, due to begin early next year, is bound to be much fiercer than the last one. Some government ministers are beginning to wonder whether the Alliance for Jobs should

not be quietly scrapped before it is blown asunder.

The sheer cost of labour—in industry, it is the world's highest—is arguably the biggest single obstacle to job-creation. Employers, as they do everywhere, blame welfare charges, shared equally by employer and employee. These equalled 42.3% of gross wages when Mr Schröder first came to power. He promised to bring the figure down to under 40%, and by transferring some pension costs to the general budget he has lowered it to 40.8%. But now rising health-insurance premiums look set to push this back over 41% again. Since it is total labour costs that count, employers would do better blaming themselves—as they do nowhere—for the (much larger) share of these costs, simple wages, that their representatives negotiate. But that is not how they see it.

Nor how Mr Schröder sees it. Earlier this year, ever the populist, he blamed the jobless themselves for high unemployment. "German workers have no right to laziness!" he thundered, threatening that anyone who rejected a reasonable job might find his benefits cut. Now, with his goal of lowering unemployment to 3.5m by election time looking ever more implausible, he has turned his wrath on the employers, accusing them of failing to create enough jobs. "If we don't achieve that," he said this week, "we'll have to ask ourselves what went wrong." He might usefully begin by examining his own record. He is not the only one who should do so, nor has he done as much harm as is often said. But he has not done the good that he could have done.

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Ethnic conflict in Macedonia

Waiting

Jul 12th 2001 | TETOVO
From The Economist print edition

For peace, perhaps. For more fighting, probably

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EPA

That's Albania's flag the Macedonian police have seized. And another one

HOLED up with a large-calibre American sniper's rifle in a ruined house on the slopes of the ethnic-Albanian quarter of Tetovo, the rebel sharpshooter could open fire on any target within 1,000 metres across Macedonia's second-largest city. And, like others, he is ready to.

Supposedly, a ceasefire has put Macedonia's insurgency, now in its seventh month of violence, on hold. But this week the rebel National Liberation Army set up roadblocks in and around Tetovo, in effect taking control of many suburbs and surrounding villages. Some of these heavily manned roadblocks are only a few hundred metres from the sandbags of police positions. The police mostly hold their fire; they are under orders not to break the ceasefire, on whose continuance all hope of successful political negotiations depends. Instead, the rebels claim, the government is sending armed civilians to do the shooting. Certainly, it is using Serbian, Ukrainian and Bulgarian mercenaries. If it is using civilians, that is new.

The NLA can afford to wait. It reckons it has the military upper hand. Its forces may be the weaker, but they have shown that they can resist months of everything, artillery bombardment and helicopter strafing included, that the inexperienced government troops can aim at them. There are bigger forces nearby, of course: NATO has warned the rebels that any attack on Skopje, or the capital's airport, might be taken as an attack on itself. But even then, what happens?

NATO has said that it is ready, if the ceasefire holds, and if there is a political peace deal, to send in a force of up to 3,000 men to disarm the rebels. But it worries whether it could even do that, and get out again within the six weeks it talks of, rather than find itself drawn in as a long-term peacekeeping force. Still less does it want to come in shooting from the start.

Neither of its two conditions looks likely to be met. Macedonia's Slav and ethnic-Albanian political parties have before them a draft framework of constitutional reforms, intended to meet Albanian grievances, drawn up by local and western experts. But the Slav side is split. The hawks are led by the prime minister, Ljubco Georgievski, backed by the interior minister, who controls the heavily militarised police force. The doves, under President Boris Trajkovski, believe these hardliners instigated the recent violent protests outside the parliament building in which westerners were attacked and the president's office shot at. The hawks are also believed to be backing paramilitary organisations ready to attack civilian Albanians if the rebels kill too many policemen or soldiers, or occupy too much more territory.

But just suppose the ceasefire holds, and the four Slav and Albanian parties represented in the two-month-old coalition government can agree on and implement a constitutional reform. NATO troops will arrive, set themselves up around the towns of Tetovo, Gostivar and Kumanovo, and start collecting rebel weapons. The ethnic Albanians will see their language officially recognised, and their community given equal political rights with the Slav majority. In their villages, the Slavs manning the local police posts may be replaced by Albanians. Contented, the rebels will hand in their arms to NATO and largely fade away. The European Union, which put Macedonia on the road to full EU membership with a stabilisation and association agreement signed in April, will start deploying the *euro*50m ($42m) of aid that it has promised. And the government no doubt will replace its helicopters with flying pigs.

Yet the alternatives are grim. Suppose, say, that the NLA entices NATO in with a promise to disarm and then attacks the government forces across a line of NATO troops. Imagine a serious outbreak of paramilitary violence, typically the first step to disintegration in a Balkan country. A visiting EU-American delegation said last week, hours before the ceasefire took nominal effect, that Macedonia was as close as it had ever been to erupting into total war. A week later, little has happened to make that prospect seem much farther away.

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Russia's armed forces

Come on, look like soldiers

Jul 12th 2001 | MOSCOW
From The Economist print edition

The forces are being slimmed and reformed. And don't they need it

Get article background

REFORM at the top, decay at the bottom. That is the state of Russia's huge but miserable armed forces. The past week's news gives a vivid snapshot of the mess.

In Rostov, in southern Russia, two deserters shot six other soldiers and hijacked a series of cars before being caught at a roadblock. They told journalists that they wanted to set up a criminal gang. In Russia's westernmost province, the enclave of Kaliningrad, a conscript, said by friends to be easily excited, stole a rifle and ammunition, and then a car, which he crashed. He was captured after wounding a policeman. Some deserters in the same region recently killed five people in a farmhouse. Another conscript, when he deserted this week outside Moscow, carried off a sub-machinegun and 600 rounds with him.

The commonest reason for such incidents is bullying, which is endemic in the Russian armed forces. Another is the quality of the conscripts, some of whom have mental problems, criminal records, or both. For the first time in modern Russian history, some are wholly illiterate.

This same week the Baltic fleet, supposedly one of the best bits of the Russian armed forces, announced that 19 sailors had died in accidents in the first half of the year. Nothing unusual there: the figure was 38 last year, and 30 in 1999. Western admirals would be sacked if they lost even a handful of lives that way.

In charge of this shambles is one of Mr Putin's closest pals, the new defence minister, Sergei Ivanov. An urbane, polyglot ex-spy, he is trying to speed up reform and improve the forces' abysmal public image. Last month he sacked the deputy chief of the general staff in charge of public relations, General Valery Manilov, whose bluster about the war in Chechnya had provoked ridicule among outsiders.

Another overdue step has been to recognise that the Russian army's record in Chechnya deserves scrutiny, to put it mildly. In the past, allegations of brutality, torture and abduction have brought only denials, even when a mass grave was unearthed earlier this year near the Russian military headquarters of Khankala. After brutal raids this month on three Chechen villages, Assinovskaya, Sernovodsk and Kurchaloy, the military prosecutor's office has this week launched an investigation, and senior Russians have even apologised. Officials say 82 criminal cases have been opened against Russian soldiers in Chechnya. But a colonel on trial for raping and killing a Chechen teenager looks likely to escape on "mental health" grounds.

Whether this changes anything on the ground is another story. The war seems as unwinnable as ever. There is no sign that the Kremlin's puppet regime, or the soldiers who keep it there, are winning over Chechen hearts or minds. Russian intelligence sources insist, as ever, that the rebels are demoralised and all but beaten, surviving only thanks to drug-smuggling and support from Islamic extremists abroad. One notorious Chechen gang leader, Arbi Baraev, was indeed hunted down recently. But all the main rebel commanders remain at large, and Russian casualties, mostly from mines and snipers, mount by the day. The official casualty figures so far are 3,433 dead since 1999 and 10,160 wounded; many believe the real numbers are higher.

All this explains why Mr Ivanov is trying to get things moving. One of his deputies is attempting to make the military budget less leaky. This week his officials ordered the closure of trading firms linked to the defence ministry, which are widely seen as a swamp of corruption. This week too Mr Ivanov said that troop numbers would be cut faster. So far this year 20,000 officers have been laid off. A further 70,000 are due to go by the end of the year, and 365,000 in 2002. Crude cuts, though, are only part of the answer. Russia has to create modern forces matching its current military needs. That means raising standards, conditions and morale.

It is not a new problem. Mr Ivanov recently quoted an anguished letter about officers' living conditions. "It is simply impossible for an officer to feed and clothe a family on his salary. As a result, good officers are leaving, and it is impossible to recruit new ones." His punchline was that the letter was written to a tsarist defence minister, some 90 years ago. An interesting point—but not a comforting one, given that defeat and revolution soon followed.

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Albania's election

On the road to normality

Jul 12th 2001 | TIRANA
From The Economist print edition

So its re-elected prime minister hopes

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AP

Meta dreams of the EU

ROAD-building is a useful vote-winner, especially in countries struggling to shake off poverty. Nowhere more so than in Albania, where pot-holed lanes are the rule, a legacy of Stalinist days when private cars were banned. Just days before the voters went to the polls on June 24th, in the first of a two-round general election, the governing Socialists opened a new four-lane highway from Tirana to Durres, the main port and, almost as important, the nearest stretch of beach to the capital.

Ilir Meta, the youthful prime minister, pulled off another coup just in time for the election. His determined effort to keep Albania out of the ethnic conflict in Macedonia was rewarded at the EU's summit in Gothenburg. Talks are to start later this year on a stabilisation and association pact with the EU, a sort of beginners' agreement for Balkan countries (Macedonia and Croatia have already signed up) that aspire to be admitted in the next intake but one of EU enlargement.

The result, unsurprisingly, was a solid victory for Mr Meta and his Socialists; and by the standards of Balkan elections, a fairly clean one. After the second round, on July 8th, the Socialists had won 70 out of 140 seats in parliament. They were also ahead in another four constituencies where irregularities had been judged serious enough to warrant a re-run. The right-of-centre Democratic Party captured 42 seats, the remainder going to four small parties. The Socialists finished with 42% of the vote, to 36% for the Democrats.

Observers from the Organisation for Security and Co-operation in Europe and the Council of Europe reported some instances of voter intimidation and ballot-box stuffing, but the violence that made past Albanian elections dangerous for participants and observers alike was noticeably absent. Predictably, Sali Berisha, the mercurial former president who heads the Democrats, refused to accept defeat, alleging fraud had been widespread. But this time, instead of urging his supporters to demonstrate in the streets of Tirana, Mr Berisha said would take his case to the European Court. Indeed, on election night, the capital was oddly subdued.

Mr Meta says he wants to team up again with smaller pro-EU parties like the Democratic Alliance and the Social Democrats that were part of the Socialist-led coalition last time. This would give the Socialists the 84 parliamentary votes needed to elect a new president next year. Their party leader, Fatos Nano, a tough ex-communist, is keen to make a come-back after losing the prime minister's job in a party bust-up. The post carries few powers, but he is still hungry for a chance to lord it over Mr Berisha, an old rival who sent him to jail in the mid-1990s for political offences.

Some observers fear that a revival of that feud might undermine Albania's still fragile stability; memories of the anarchy that followed the collapse of a dozen pyramid finance schemes in 1997 and brought down Mr Berisha are only just starting to fade. Yet the Socialists' second straight election win, a rare event in the Balkans, has strengthened Mr Meta and his young, pro-EU supporters in the party. They may yet make Albania what West Europeans will think of as a normal country.

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Charlemagne

Goran Ivanisevic

Jul 12th 2001
From The Economist print edition

Croatia's Wimbledon-winning tennis player is a true symbol of Croat nationalism

HE RUNS, he leaps, at times he skids. He thumps, exceedingly hard. He makes a lot of noise. He is emotional, and a crowd-puller. He can be deadly to his opponents, and all charm to them half an hour later. He knows God is on his side—which plainly is more than God knows, because, above all, he's erratic and generally he loses. This week was the astounding exception: to the roars of his Croatian compatriots, Goran Ivanisevic, a wild-card entrant out of sight in the world ratings, won the most treasured prize in tennis, the men's singles title at Wimbledon. And, though he is absolutely not a fanatic, a proud Croat he is, and a very appropriate symbol of Croat nationalism.

The spitting image of it, you might say. Nasty Goran one moment, nice Goran the next, he readily admits to a split personality, as well he may, being born in the city of that name 29 years ago. Just so did Croatian voters in early 2000 replace the near-dictatorship installed by Franjo Tudjman, their newly dead first post-communist leader, with a government of almost unnatural democratic virtue and zeal to join the EU. And when Mr Ivanisevic is on court there is usually some hefty racket going, just as there was among the Croats of Bosnia, whose favourite bank had to be stamped on by the United Nations this year for its financing of separatism, smuggling and other dubious activities.

This week too Croatian nationalism faced one of its hardest tests, though one in which, paradoxically, its best chance of durable victory is surrender. The coalition government of Ivica Racan has been under pressure from the UN war-crimes tribunal at The Hague to hand over two generals for crimes committed against Serbs during the fighting of the mid-1990s. With Serbia's Slobodan Milosevic behind bars, the UN thought it was time to show its justice was even-handed, and its chief prosecutor, Carla Del Ponte, was in Zagreb on July 6th demanding action. By a majority, the cabinet agreed to give way—and promptly lost three ministers, because their party, the Social Liberals, Mr Racan's main coalition partners, disagreed. The Social Liberal deputy prime minister stayed on, because he disagreed with his party. But even so Mr Racan had to cast about for new allies and call a confidence vote in parliament for this weekend.

To many Croats, to give up the generals would be a betrayal. Sure, there were crimes; in truth—not the Balkans' best-known product—many and foul ones, as Serbs who had lived for generations in Croat lands were brutally expelled, or killed before they fled. But were the generals not fighting for the nation, against the hereditary enemy? Hereditary enemy? Their Serb brothers? That's the point at which, repeatedly during the past decade, West European eyebrows have been raised in surprise. Granted, Serbs and Croats differ in their versions of Christianity. But, though they use different scripts for it, do they not speak virtually the same language? Were they not, for some 70 years, all Yugoslavs, united by the long history of alien rule that preceded that country's invention soon after the first world war?

So they were—except that it was exactly alien rule that disunited them. The Croats for centuries were under Hungarian, then Austro-Hungarian rule. That is why they are Roman Catholic, and historically have looked northward, coexisting with their foreign overlords, often at odds with them but not at war. The Serbs for even longer were part of the Turkish empire, but for them coexistence was dotted with repeated episodes of armed resistance. Early in the 19th century, as Turkish power grew weaker, they broke into open revolt. The Russians, Orthodox Christians like the Serbs, came to their aid.

The struggle against the Turks went to and fro, until, again with Russian help in 1877-78, the Serbs achieved independence (and the freedom to resume the clan vendettas, Karadjordjevic against Obrenovic, that had dominated their history since the first Black George raised the standard against the Turks in 1804, and later had his head cut off by the first of the Obrenovic dynasty). And what were the Croats doing all this while? Arguing with Austro-Hungary, on and off, but still ready to be run by it, rather prosperously. Indeed in 1914-18 they were fighting, if not all of them willingly, in its armies against their

Serb cousins.

Little wonder that when the new Yugoslavia was born (and even that unifying “South Slav” name was not adopted at once), the Serbs saw themselves as the real winners and representatives of national freedom, while many Croats quite soon saw them as oppressors. Hence the rise of Croatian nationalism and its extremist arm, the Ustasa terrorist movement. Hence, after the German invasion of 1941, the creation of a puppet Croat kingdom, under German tutelage and nominally ruled by an Italian duke, but run, a good deal less nominally, by the Ustasa leader, Ante Pavelic. His short-lived regime was marked by massacres of Serbs and the destruction of Orthodox churches. If this was brotherhood, it was that of Cain and Abel.

The proper place for champions

And, for all the decades of communist rule under Tito, neither Serbs nor Croats have forgotten the divisions of the past. It is these, more than anything, that define their rival identities. Hence the red and white flags—the colours of Croatia, but also in earlier days of the Ustasa—that swamped Croatia as they had swamped Wimbledon when Mr Ivanisevic won his famous victory. Hence, maybe, the double edge of his remark that a Dutch prison is where a man like ex-President Milosevic deserves to end his days. And watch him as he crosses himself, thanking heaven for the point he has just won. The gesture is that of a Christian, but not just any Christian: the hand movements are, specifically, Catholic ones, not those of Orthodoxy. Mr Ivanisevic is no more a politician than Mr Milosevic is a tennis player. But here is a Croat, not an ex-Yugoslav. Do not be surprised that some Croats carry such feelings to the point of reckoning that the place for Croatia’s champions is on court, not in it.

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Public services

Socialism in one country

Jul 12th 2001 | BRUSSELS
From The Economist print edition

The idea of giving the private sector a big role in public services is contentious in Britain. In the rest of Europe, it's commonplace

IT IS now widely accepted in both Britain and Brussels that the centre of political gravity in the United Kingdom is some way to the right of that in continental Europe. When it comes to issues such as taxation and trade unionism, that may be true: Tony Blair has accepted most of the Thatcherite inheritance, and is calling for economic liberalisation across the EU. But the same cannot be said of the issues on which Mr Blair fought the last election, health and education. Compared with the way those services are run in mainland Europe, health and education in Britain are run by centralised, egalitarian, socialist-style systems.

Britain's National Health Service is a centrally-planned, government-funded institution, which responds to excess demand in the classic style of a nationalised industry—by rationing. In much of continental Europe, by contrast, governments take a more flexible and pragmatic approach to both the funding and the provision of health care.

Britain's state education system is comprehensive and non-selective. The government has tried, nervously, to introduce change; but it's hard, because the Labour Party is wedded to a system that it introduced in the name of egalitarianism. Other European countries have no such hang-ups. Germany and the Netherlands, which are both instinctively egalitarian countries, nonetheless have secondary-school systems that filter children into academic and vocational streams. In Britain, such an idea would still be dismissed with horror as condemning the non-academic to sink schools and educational failure. Yet the selective German and Dutch systems produce far fewer illiterate and innumerate school-leavers.

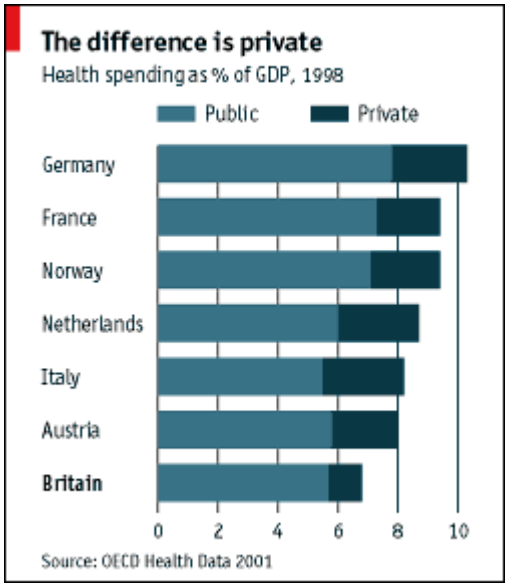
Both in Britain and on Europe's mainland, it is widely assumed that the problems with Britain's public services are the consequence of Britain's relatively low taxes. The British habitually talk about the under-funding of the health service, and Mr Blair has promised to raise British health spending to the European average; French newspapers love to dwell on the "Dickensian" state of Britain's public services, and to use this as a justification for their own country's relatively high levels of taxation.

Many European countries certainly spend more taxpayers' money on health. But it is the difference in private, not public, health spending that accounts for most of the gap (see chart). In 1998, according to the OECD, the Netherlands spent 8.7% of GDP on health, Italy spent 8.2%, Austria spent 8% and Britain spent just 6.8%. But expenditure by the state was rather similar; Italy spent 5.5%, Britain 5.7%, Austria 5.8% and the Netherlands 6%.

Even in the higher spending countries, such as France and Germany, most of the gap was accounted for by private-sector spending. By accepting a mixed system, based on social insurance, rather than a taxation-based system in which the government is overwhelmingly the single buyer of health care, continental Europe has succeeded in bringing more money into health care.

The idea of paying a fee to see your family doctor would be

regarded as dangerous in Britain—the first step on the road to the privatisation of the NHS that Mr Blair has sworn never to allow. But go to see an equivalent to your GP in Germany, France, Austria and Belgium and you will be expected to get your wallet out at the end of the appointment. Most—but not all—of your expenses will usually be reimbursed by your insurance scheme.



In France, typically only 85% of out-of-pocket expenses are subsequently reimbursed by insurers, and 80% of the public have taken out private, voluntary, top-up insurance, in addition to the social insurance provided by their employers or the state. In Germany, meanwhile, over 50% of hospitals are run on a private or independent, non-profit basis; these hospitals then provide services to the state or insurers on a contract basis. Yet the idea that anyone other than the state should own hospitals that do work for the NHS is already provoking apoplexy on the Labour back-benches. Perhaps those apoplectic MPs might reconsider if they realised that Germany's mixed health-care system provides seven acute hospital-care beds per 1,000 people, while Britain's manages just two.

My money, my choice

More private funding does not just bring more money into European health services. It also gives consumers more choice. In Germany, for instance, where employees must join a health-insurance scheme, they have 500 to choose from. Funds compete both on price and on the range of benefits offered. Some half a million people switch funds every year. That's a common pattern around Europe. And, across Europe, people spend more money buying health care direct than through insurance schemes. That means they are choosing their doctor and their hospital as they would choose their hairdresser. And the more people have the ability to choose the health care they want, the more responsive the country's system will be to their demands.

The idea that the main problem with British public services is under-funding stemming from low taxation does not stand much scrutiny when it comes to education, either. The Netherlands spent 4.6% of GDP on education in 1998, while Britain spent 4.9%. Yet it is undeniable that the Dutch get better results. In 1999 only 10% of Dutch adults had difficulty reading and writing, compared with 23% in Britain. In the Netherlands, 65% of school pupils are educated in schools run by private foundations, which control their own admissions systems.

The more people have the ability to choose the health care they want, the more responsive the country's system will be to their demands

Germany—which does spend about 20% more per secondary-school pupil than Britain—provides another example of the successful use of local autonomy and streaming. Regional governments run their own education systems, which are even more rigidly streamed than those in the Netherlands. Germany offers four levels of state school with differing curricula tailored to the academic abilities of the pupils. Nick Clegg, a Liberal Democrat member of the European Parliament who is conducting a comparative study of public services in Britain and continental Europe, comments that: "There is a degree of selection and autonomy in most mainland European educational systems which the centralising Thatcher, Major and Blair governments could never tolerate."

Unfortunately, even "pro-European" political parties in Britain appear not to have noticed all this. For the moment, Mr Clegg's own Liberal Democrats seem to be sticking to the notion that it is spending levels, rather than structures, that set the British education and health systems apart from the rest of Europe. The Labour government is tip-toeing around the notions of selective education and greater private-sector involvement in health care—but it seems to have got stuck on the notion of private-sector management, when the bigger issues concern funding and the provision of services, as well, most critically, as the extent of consumer choice.

Stephen Pollard of the Centre for the New Europe, who wrote a book on public policy with Andrew Adonis, the new head of Tony Blair's policy unit, says that Britain is not yet ready for a fundamental debate on health provision, but that the government's current spending splurge means that "for the first

time ever, people who always said the problem with the NHS is that we don't spend enough money on it are going to find out if it's true." And when it turns out not to be, then maybe Britain can really talk about reform.

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Road pricing

The mayor's £5 flutter

Jul 12th 2001
From The Economist print edition

Road charges will have to be much higher than proposed to cut congestion

KEN LIVINGSTONE, the mayor of London, is not one to duck a challenge. This week, he staked his political career on a plan to charge motorists a £5 fee to enter the central area of the capital (see map). The howls of outrage from motoring organisations and political opponents that greeted the announcement are an indication of just how big a political gamble he is taking.

Mr Livingstone has set himself a tight timetable—18 months—for introducing the scheme. He may be able to do it. The scheme will use familiar technology—roadside cameras linked to a central computer database. Drivers can pay the fee either in advance or retroactively up to midnight on the day they enter the charged zone. Similar charging schemes in Oslo and other Norwegian cities have been working well with little controversy for nearly a decade. In Singapore, a more ambitious variable electronic tolling scheme has reduced rush-hour traffic by up to 20%.

Still, London is bigger, more complex and politically volatile. Nearly 750,000 vehicles pass in and out of the charged area every day. There are bound to be teething problems with the technology. The scheme is likely to cause congestion just outside the zone. The use of "rat-runs" is also expected to increase as motorists try to weave their way around the charged area.

The political timetable is tight, too. The next mayoral election is 2004, the year after the scheme is due to be introduced. Whether Mr Livingstone gets re-elected may depend largely on whether he has been able to persuade Londoners that the benefits of the scheme outweigh its costs.

That is why the charge has been set so low. For drivers paying £6 an hour to park in inner London, £5 is small change. For that reason, it is unlikely to have much impact on congestion. The forecast is that it may, at first, reduce traffic by around 15% (less in inner London). But, as has happened in other cities, after that initial fall the traffic is likely to build up again. The main impact of the charge in the short term will be to raise £200m a year for Mr Livingstone to spend on public transport.

If Mr Livingstone really wants to reduce congestion, as he says, he will have to impose much higher charges: £20 a day would have a real impact. Politics dictate that he should put off such a radical move for the moment, but it may be something for Londoners to look forward to after the next mayoral election.

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About sponsorship

Riots and multiculturalism

Alone, together

Jul 12th 2001
From The Economist print edition

Riots in segregated northern towns say less about the prevalence of racism than about the dangers and limits of multiculturalism

Get article background

Reuters

Bradford's Asians celebrate their difference

THE spasmodic rioting that has skipped between towns in the north of England this summer returned last weekend to Bradford, where, in April, it first reared its head. As in Oldham, Burnley and elsewhere, white and Asian youths fought each other and the police. In Bradford, cars were torched, businesses were firebombed and, on July 7th alone, 164 police officers were injured. The after-shock confrontations continued for several days.

As with the riots that erupted across Britain in 1981, there has been much dispute about whether, and how accurately, these disturbances reflect the state of race relations in their host towns. Rioting, after all, tends to be contagious—especially when, as was the case in Bradford, extremists on both the left and right help to spread the disease. Hot weather has been a common catalyst. In the longer term, the roles of poverty and race are difficult to disentangle. Much of the Asian population in these towns came to Britain to work in the textile industry. Mill closures in the late 1970s and early 1980s induced unemployment and poverty in both the white and Asian communities, creating an atmosphere of misinformed envy about who was getting what from the public purse.

The lunacy of a small number of hotheads certainly does not prove, as some observers might deduce, that race-relations are yet another area in which Britain is a bumbling failure. For one thing, the experiences of the country's various ethnic minorities are not susceptible to such a generalisation. For another, public opinion polls and election results tend to prove that Britain is not especially racist by European standards. In one of the few dramas of general election night, Nick Griffin, leader of the British National Party (BNP), secured 16% of the vote in Oldham West (his party also did well in Burnley). But compared with far-right parties in France, Germany, Italy and parts of Scandinavia, the BNP are marginal agitators.

The lunacy of a small number of hotheads certainly does not prove that race-relations are yet another of Britain's bumbling failures

The enemy within

The troubles in these towns say less about racism than about the fuzzy doctrine of multiculturalism. It is now a truism among all mainstream politicians that Britain is a multicultural society; that minority traditions should be respected; and that difference should be celebrated rather than deprecated. Anyone who argues for compulsory assimilation by immigrants is dismissed as a xenophobe or worse.

Social policy reflects this multiculturalist attitude. To be sure, its implementation in Bradford and elsewhere has sometimes been warped by racism, but in general it has tried to enable Britain's ethnic minorities to live and be educated as they like. Muslim schools, for instance, can get state funding, just as Christian ones can; nobody disputes (as they do in France) the right of Muslim girls to wear headscarves in schools.

Multiculturalism, though, is a problematic creed. It is generally assumed that, as Tariq Modood, of the University of Bristol, insists, “multiculturalism is the opposite of assimilation”. But for a society to be truly multicultural, some degree of assimilatory mixing is necessary—otherwise communities end up living not together but separately, divided rather than harmonious.

Whatever the precise chemistry of this summer’s flare-ups, that is what has happened in several British cities. A report on race-relations in Bradford, written before the disturbances by Lord Ouseley, a former chairman of the Commission on Racial Equality, says that the city’s whites and Asians (mainly Pakistanis) are growing apart rather than together. In terms of physical segregation by housing, this is true of many south Asian communities across the country.

Analysis by Ceri Peach, of the University of Oxford, shows that whereas Caribbean blacks have tended to desegregate over time, south Asians have tended to cluster together even more. The level of segregation of the Pakistani community in Bradford is high but not exceptional for Pakistanis nationally. Bangladeshis tend to be even more segregated.

British blacks, especially those born in Britain, also marry whites vastly more than do the south Asian minorities. Many of these prefer arranged marriages, an awkward subject for liberal multiculturalists. (Indeed, British blacks marry whites far more than do their counterparts in America, where blacks are often ghettoised in a way unrivalled by any minority in Britain.) As well as being the most segregated communities, Bangladeshis and Pakistanis suffer some of Britain’s worst poverty and unemployment, and do among the worst in school (Indian pupils, by contrast, do the best).

Multiculturalism isn’t supposed to be like this; but it’s difficult to know what to do about it. Compared with some other countries, British policymakers have tended to think more about the rights of minorities, in relation to various wayward organs of the state, than about their responsibilities. Lord Ouseley’s report scolds Bradford’s schools for failing to encourage integration. Probably, though, the government should not and could not compel the races to mix, for such compulsion would be a greater evil. Perhaps the lesson for multiculturalism is simply that giving people choice means taking risks.

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Virgin Rail

Tilting too far?

Jul 12th 2001
From The Economist print edition

Unless Virgin Rail can get lots more passengers, its sums will not add up

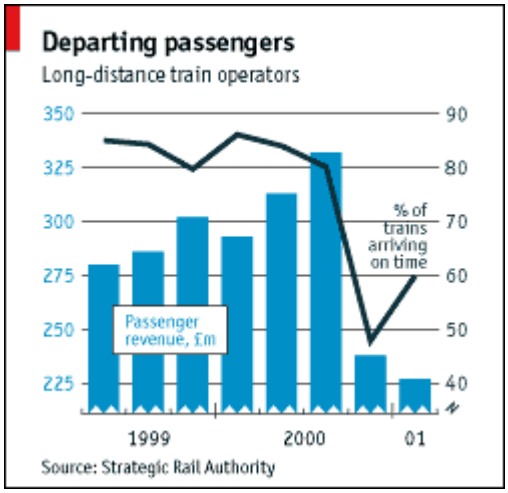
Get article background

Just the ticket?

WITH the usual laser beams and clouds of dry ice, Sir Richard Branson this week unveiled the first of the 53 tilting trains due to enter service next year. These are designed to replace all the ancient rolling stock on Virgin Rail's west-coast line from London Euston to Birmingham, Manchester and Glasgow. Virgin hopes that these fast new trains, running at up to 140 miles an hour, will double passenger numbers on the line by 2007. This ambitious target is as much the product of financial necessity as of marketing hype; if Virgin does not come near this target, it could be in financial trouble.

Virgin's growth target was always twice as ambitious as the rest of the rail industry. But, in the light of depressed traffic trends on inter-city routes since the Hatfield disaster last autumn, it now looks outlandish. The delays caused by emergency repairs to the network, resulting in poor punctuality, have driven passengers to jump on low-fare airlines or get back into their cars. As a result, passenger revenue on such lines was down 23% in the first quarter of this year compared with the same period last year (see chart). In the previous year it had risen by 12% .

All this is reflected in the latest financial results of Virgin Rail (half-owned by the Stagecoach group), including its other franchise, Virgin CrossCountry. In the year to the end of April, Virgin Rail's turnover fell by 8% and it recorded an operating loss of £7m, compared with a profit of £28m in the previous year. Since then, there has been more bad news. At the very time when Virgin was hoping to get its act together after the Hatfield side-effects, its punctuality slumped dramatically in May. Whereas in March and April around two-thirds of its west-coast trains arrived on time, in May the figure fell to fewer than half.



To add to the company's troubles, the Advertising Standards Authority ruled recently that an advertising campaign, launched by Virgin Rail in February to attract passengers back, was misleading. This was the third such adjudication against Virgin Rail in the past year.

Virgin's desperate search for traffic growth is driven by the financial commitments it made to the government when it bid for the west-coast franchise. After a number of years collecting subsidies, Virgin is due to start paying an annual premium to the government out of its expected profits on the line. This year Virgin collects its last subsidy, worth £56.5m; next year it pays its first premium, £4.2m. Over the subsequent nine years, it has to pay the government £1.35 billion.

The first of the tilting trains enters service next summer. They will enable Virgin to run nine trains an hour out of Euston on the west-coast line, compared with only six an hour at the moment. But, to meet its traffic targets, Virgin needs to run 11 trains an hour. It cannot do that until Railtrack, which owns and operates the line, completes the second stage of the line's upgrading. This consists of some new track and fancy signalling, which will allow the trains to run at their maximum speed.

There have been fears that the troubled track operator would not proceed with this second stage of the west-coast upgrade, especially since the original estimate for this work has risen from £600m to around £2 billion. This would bring total spending on repairing and upgrading the west-coast line to £6.3 billion, compared with an original estimate of £2.1 billion.

The nail-biting aspect of all this for Sir Richard is his heavy reliance on Railtrack getting it right. Several Railtrack executives in charge of this project have left the company. Now Steve Marshall, who was appointed chief executive of Railtrack last November when his predecessor, Gerald Corbett, resigned, has taken personal charge of the work.

All these problems could not be happening to Sir Richard at a worse time. Last year he sold 49% of his airline, Virgin Atlantic, to Singapore Airways. Sir Richard used a sizeable portion of the net proceeds from this sale to bail himself out of financial difficulties within his then deeply indebted retail empire. That part of his group recorded a pre-tax loss of £127m in the year to January 31st 2000.

Recently, the only significantly profitable part of Sir Richard's empire has been his airline. But in the year to April 30th 2000, the pre-tax profits of this business more than halved to £40m. What is more, Sir Richard has now pledged his remaining stake in his airline to bankers for loans which he says he is using to fund expansion of his mobile-phone operations. With more and more of his empire, in effect, ring-fenced, Sir Richard has far less room for manoeuvre than in the past. He needs those passengers to come back.

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Inward investment

Top grade

Jul 12th 2001
From The Economist print edition

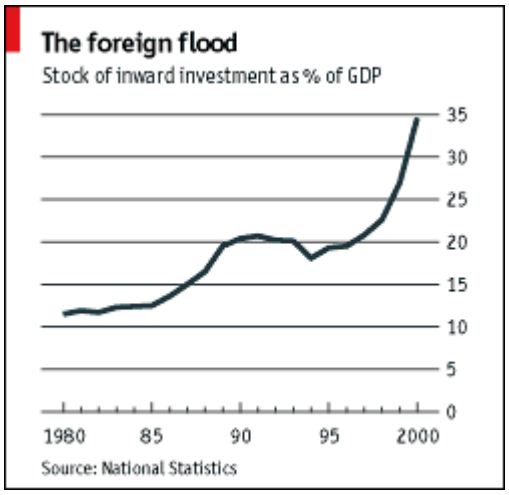
Britain has not put off inward investors by staying out of the euro

A WARM welcome to foreign companies wanting to set up shop in Britain has been one of the few industrial policies pursued with any consistency by successive governments over the past 25 years. But since 1997, when Gordon Brown set his five economic tests to determine whether Britain should join the euro, inward investment has attained a new political salience. This is because one of the tests asks whether joining the single currency would "create better conditions for firms making long-term decisions to invest in Britain".

Although this test also encompasses investment by British firms, inward investment has become the gauge for how Britain has been scoring. Euro-enthusiasts argue that Britain is doomed to become less attractive to foreign firms while it remains outside the euro area. Companies producing for the European market will start to shun locating in Britain because of the exchange-rate risk that they face.

So far, however, these fears have proved groundless. Outside the euro, Britain has been doing famously. The first two years of the single currency have brought bumper harvests of inward investment by foreign companies. Last year, they invested £86 billion—equal to nearly a tenth of GDP and almost two-thirds more than in 1999. For most of the 1990s, the stock of inward investment was worth about a fifth of GDP. However, it has now jumped to more than a third.

This week, Patricia Hewitt, the trade and industry secretary, announced new figures from Invest.UK, the government's inward investment agency. In the year to March 2001, there were a record 869 new projects. The number of new jobs created jumped by a third to 71,488. Ms Hewitt said that the results showed that membership of the single currency was only one factor for inward investors who looked at the overall business environment.



The potential impact of the euro on inward investment matters, because foreign firms are a catalyst for better economic performance. For one thing, they invest more, employ more skilled people and are more productive. In manufacturing, for example, foreign-owned firms produce about 40% more per worker than indigenous companies. Foreign-owned firms now account for almost a third of total R&D expenditure by businesses, double their share ten years ago.

The beneficial effects of foreign investment by companies are not confined to their owners and workforces: they "spill over" to the rest of the economy as domestic companies and their workers learn from best practice. According to the National Institute of Economic and Social Research, the increasing importance of foreign firms in the economy has spurred technological improvement elsewhere. The impact has been particularly marked in manufacturing and where American firms are the inward investors.

However, the outlook for inward investment is less rosy now than it has been for several years. The precipitate slowdown in the world economy is to blame, rather than Britain's position outside the single currency. The downturn is already affecting projects in e-commerce, information technology and telecoms, according to Invest.UK.

Cross-border mergers and acquisitions (M&A), which have helped drive the recent boom in foreign

investment, have nosedived, according to KPMG, an accountancy firm. The value of deals slumped by over a half in the first half of the year compared with the same period in 2000; their number fell by a third. “This was the first decline in numbers of deals in ten years,” says Stephen Barrett, vice-chairman of KPMG Corporate Finance. “In M&A terms, this constitutes a recession.” Mr Barrett does not expect any pick-up for a year.

Given these trends, inward investment is likely to fall in the year ahead. But what will really matter in the euro debate is how Britain does compared with other European countries. In the second half of the 1990s, Britain increased its share of the total stock of inward investment in the EU from less than a fifth to almost a quarter. There will be cause for concern only if Britain now starts to lose that market share. Britain is vulnerable, says Barry Bright, director of international location at Ernst & Young, an accountancy firm, because of its dependence on American investors and because of the difficulties manufacturers have faced outside the euro. But that vulnerability has not shown up yet.

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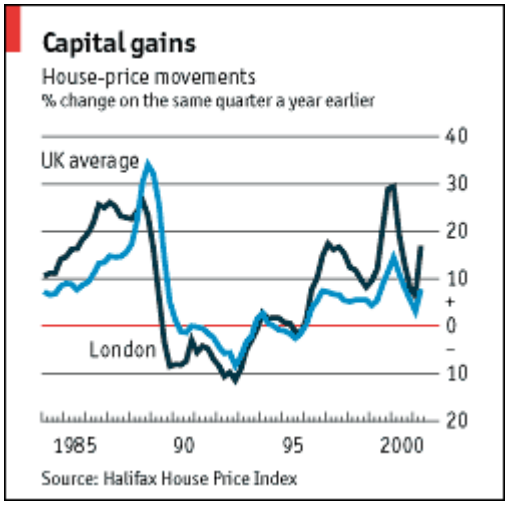
House prices

The London effect

Jul 12th 2001
From The Economist print edition

The gap between prices in London and elsewhere is not likely to shrink

THAT favourite dinner-party topic is back. London house prices, which were subdued for much of last year, are now marching up again. In the year to the second quarter they rose by 17%, over double the national increase. By contrast, house prices rose by just 4% in Scotland and the north, according to the Halifax price index.



The resurgence in London house prices has reawakened fears that the housing market may once again be heading for boom-and-bust. The last episode in that unhappy cycle occurred in the late 1980s and early 1990s. Then, the London market led the way to soaring house prices across the country. As borrowers stretched themselves to get into the market, price-to-income ratios rose way above their long-run averages. They were restored only by the housing-market slump of the early 1990s.

Some doomsayers are already warning that this will happen again. Even before the latest jump in London house prices, Cambridge Econometrics, an economic consultancy, warned that house prices had risen to unsustainable levels.

But there are important differences between today's housing market and that of the late 1980s. Then there was an upsurge in the number of first-time buyers as the baby-boomers born in the late 1950s and early 1960s scrambled into the market. However, the size of the 25-35 age-group is now falling sharply as a result of the baby-bust of the 1970s.

Furthermore, the incentives to invest in housing have weakened since the late 1980s. The tax system no longer subsidises mortgage borrowing, tax shelters are now widely available for equity investments and low overall inflation reduces the incentive to protect wealth by acquiring real assets.

This suggests that the surge in London house prices is largely specific to the capital and the surrounding commuter-belt. London's population is burgeoning, in large measure because it receives most international migration. Its population is younger than the rest of the country. More people are in the key house-buying age-groups. The City's role as a world financial centre has driven incomes for many professions up to international levels.

Since these are relatively new developments, long-run price-to-earnings ratios may no longer apply to the capital. If this is the case, three conclusions follow, two favourable and one awkward. London house prices may not be as over-stretched as they appear, although they remain vulnerable to a downturn in the City's fortunes. The country will not follow London in a runaway property-price boom. Which means that the economic chasm between the capital and the country will remain wide, creating all sorts of difficulties, not least for the government's attempts to improve public services without banishing national pay scales.

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Prisons

Rambo's parting shot

Jul 12th 2001
From The Economist print edition

There are more women in prison now than there have been for over 100 years

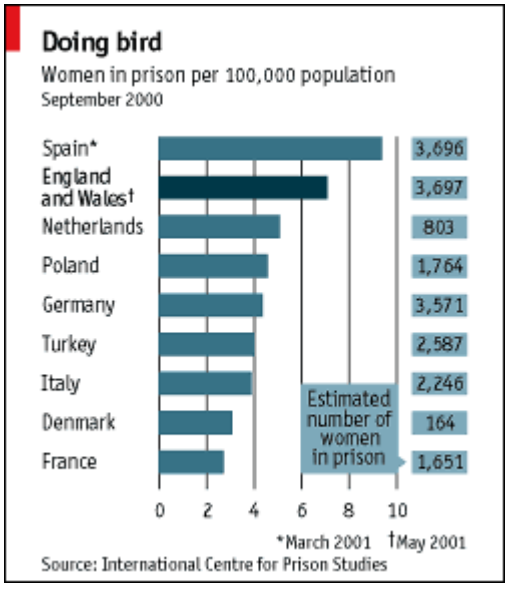
THE departure at the end of this month of Sir David Ramsbotham, the chief inspector of prisons, will be greeted with quiet jubilation in Whitehall. Civil servants have never known how to deal with this plain-speaking ex-soldier, a former commander of the British land army, called "Rambo" by his soldiers.

In his six years as inspector, Sir David has published a series of reports condemning assaults by prison officers, bullying, drug-taking, racism and overcrowding. He described the regime at Wormwood Scrubs, a London prison, as "callous and evil". His outspokenness has embarrassed ministers and infuriated prison-service officials. The civil servants retaliated by ostracising him; the government by, in effect, sacking him.

Sir David is not going quietly. This week he published a critical report on one of the subjects that exercises him most—women in prison.

There are now more than 3,500 women in jail in Britain, more than at any time since the end of the 19th century. Britain imprisons a higher proportion of women than anywhere in Europe except Spain (see chart). Nearly half of all women prisoners are first offenders and almost two-thirds are mothers, many with young children.

A report by the Prison Reform Trust noted that jailing so many women, often for relatively minor and non-violent offences, does untold damage, not only to the women but also to their families. Sir David says that probably a third of women prisoners should have been given an alternative form of punishment.



Many women's prisons are awful places. Sir David described Holloway, one of the biggest, as in a "continual state of crisis", and criticises the emphasis on security in women's prisons: since women are less violent than men, treatment and rehabilitation should be a higher priority than security. Yet pregnant prisoners who are taken to hospital to give birth are still, very often, handcuffed up until the moment when labour starts. The prison service, says Sir David, is excessively male-dominated. It is nonsense, he points out, that men should hold the two key policy jobs concerned with female prisoners.

More than half of women prisoners, according to Sir David's report, have severe emotional or psychological problems. There is a high incidence among them of self-mutilation, suicide and psychological breakdown. Many have suffered physical or sexual abuse. Nearly half have harmed themselves at some point in their lives.

Inappropriate imprisonment is not just bad justice: it is also expensive. A prison sentence costs three times as much as probation, community service or a curfew order. Remanding women in custody to await trial is also seven times more expensive than lodging them in special hostels.

Less radical figures agree with Sir David. Lord Hurd, a former home secretary and former chairman of the Prison Reform Trust, also believes that jail is not the right answer for many of these women.

Six years after Sir David took on the job, Britain's prisons are still among the worst in Western Europe.

So has he wasted his time? Not entirely. By complaining in his loud, military voice, Sir David has caused some improvements and a lot of embarrassment.

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Pyramid scheme

Women beware women

Jul 12th 2001
From The Economist print edition

A pyramid scheme promising participants £24,000 each is sweeping Britain

"WE ARE literally creating a new economic experience," says the blurb. In fact, Britain's women are being seduced into the oldest economic experience of all: being conned. "Women Empowering Women" is a pyramid scheme, which requires people to hand over money in the hope of seeing their cash multiply when new suckers are recruited. All such pyramids eventually crumble.

"Women Empowering Women" relies on each participant finding eight new participants, each of whom has to stump up £3,000, which is then passed up the (strictly female) hierarchy. It seems to have originated in America and to have appeared on the Isle of Wight in March. Thousands of women there lost their money after the supply of recruits dried up. Roughly two months later it resurfaced on the mainland. Since then, according to the Trading Standards Institute, it has appeared in 15 towns and cities across Britain, as far afield as London and Glasgow.

The Department of Trade and Industry says that pyramid schemes are unusual in Britain, and one aimed at women seems a novelty. But a recent government-sponsored review says that, thanks to the National Lottery, Britain is more comfortable than it used to be with gambling. That may help explain this scheme's success.

Officials don't like it, but there is nothing they can do about it. Although pyramid selling schemes, in which improbably high rates of return on bonds are financed by the next lot of sales, are against the law, nobody involved in "Women Empowering Women" is either buying or selling. Publicising the scheme's dangers is difficult, too. Those in it are anxious to extol its merits to their friends, according to Allan Charlesworth, who heads the TSI, but those who have lost out "keep quiet and put it down to experience." Such gifting schemes can grow and collapse very quickly, and "Women Empowering Women" may well have run its course already. If so, those on the lower levels of the pyramid are about to lose their money. That may not be the end of it, though. On the Isle of Wight, a group of women who lost money in Women Empowering Women have started a "community investment club" whose structure, the blurb explains, is much better than the previous scheme. Participants are asked to hand over £100 and are promised £88,300 in return.

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Bagehot

Not yet airborne

Jul 12th 2001
From The Economist print edition

Why Labour has seemed to make a slow start, and what not to do about it

DISASTER plays well at the box office. That is why so much recent political commentary has focused on the exciting attempts of Britain's battered Conservatives to choose a new leader. But here is a sobering thought for Conservatives as they make their exciting choice. They did so badly in the general election last month that, assuming no change in Britain's idiosyncratic electoral system, it would require a wholly unprecedented swing of more than 10% to give them a one-seat majority in the next general election. In other words, they can be fairly confident of being out of power for most of the rest of this decade. This makes their antics fascinating enough as anthropology, but of limited immediate relevance to most Britons.

Here, though, is a countervailing sobering thought for the government. No matter how hard you look behind the so-called "landslide" that gave Labour two out of three seats in the House of Commons, you will find nothing that anybody could describe as an overwhelming mandate. Tony Blair's party was re-elected with less than 41% of the popular vote, after four out of ten voters stayed home. The country put Labour back, probably for two more terms, but with a singular lack of enthusiasm. To make matters worse, the little enthusiasm that did exist has faltered during the first month. At parties and lunches, in the lobby and in the press, the suddenly conventional wisdom is that Mr Blair's second term has got off to a "slow start".

There are sound reasons for a re-elected government to bide its time

Has it? To Bagehot's mind, speed in politics—especially when this actually means weight, measured by the tonnage of legislation—tends to be valued too highly. There are sound reasons for a re-elected government to bide its time for a while. Newly reshuffled ministers need time to master their briefs, especially after the shape of many departments has also been chopped and changed. The early days of a re-elected government are a good time to perform some discreet but necessary U-turns. It is, for example, sensible of the government to retreat from the new AS-level exam in schools, and in hospitals to target the length of waiting times instead of, as previously, the size of waiting lists. Besides, if the quantity of legislation was the issue, Mr Blair could answer the critics of his slow start by pointing to an imposing stack of pending bills.

Last month's queen's speech promised new measures on education, health, crime and welfare. An education bill is going to promote diversity in secondary schools and give more power to successful heads and governors. A health bill will decentralise power in the National Health Service. Other new laws will crack down on money-laundering, help the police to co-operate across force boundaries and reform the working of the criminal courts. There will be laws to help more people into work, to "encourage enterprise", to safeguard consumers, to make it easier to buy and sell property and to adopt children. And in case this does not keep MPs busy enough, Mr Blair has promised (again) to find time (again) for a free vote on the future of hunting with dogs.

In short, laws galore. The problem is that a government can enact laws galore and still give the impression that it is getting nowhere. This becomes a special danger when it appears to be losing control of events outside Parliament. Mr Blair is not yet in that position. But it is striking that whereas for much of the first term he was able to make his own political weather (including some of the storms), this one is getting under way with some events beyond his control bearing rapidly down on him.

The prime minister spent a large part of the first year of his first term making peace in Northern Ireland. He is having to spend the start of his second in a desperate effort to save it. Gordon Brown, the chancellor of the exchequer, started the first term by freeing the Bank of England to set interest rates. By comparison with this, his second-term surprise, consisting of some useful measures to sharpen

competition and so push up productivity, was a whimper. With inflation and unemployment low, the good times continue, but in an atmosphere of growing fragility. A government that boasted endlessly before the election about killing boom-and-bust forever was reminded by last week's profit warning and job losses at Marconi that Britain is not immune from the global bust in IT businesses.

Think first, legislate later

The trick of a successful government is that it does not allow events beyond its control to deflect it from its intended path. That is easier if people understand what the intended path is. Everybody knows that, beyond the riddle of the euro, Mr Blair's priority is to improve the public services. But his determination to achieve this goal has run ahead of his thinking about how it is to be done. And in so far as he does have a new thought—making more use of the private sector—the idea has run ahead of the political consensus within the Labour movement. In these circumstances, it is not hard to see how a stack of legislation could turn quickly into a nightmare. Each bill causes a quarrel between right and left; none proves capable of delivering its intended result.

Some people in Downing Street have an additional explanation for what they call the "myth" of the slow start. This faction blames the spread of the myth on a deliberate change of style. Mr Blair has concluded that by promising too much during the first term, the government raised expectations too high. He wants the second term to be a businesslike affair, with maximum "delivery" and minimum spin. For this reason, Alastair Campbell, his towering spin doctor, is no longer setting out the line and laying down the law in briefings to the media. Two under-stated civil servants have taken his place. Before long, the temptation will be to summon him back, to manufacture an impression of movement and success. That would be a mistake. Let there be no return, please, to the spin of the first term. But a clearer sense of direction would be nice.

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Cable operators

Loop dreams

Jul 12th 2001
From The Economist print edition

If successful, Comcast's bid for AT&T's cable arm would create a new media giant and encourage further mergers

Get article background

FOR the venerable American Telephone and Telegraph (AT&T), the symbolism was as humiliating as the timing was audacious. On July 8th, the day before the battered telecoms group was to spin off its wireless arm as part of a four-way break-up, Comcast, America's third-biggest cable-TV operator, grabbed the headlines with a hostile bid worth $44.5 billion for the cable bit of those pieces, AT&T Broadband. If Comcast succeeds, it would create America's biggest cable company, reaching 22m customers, or over a third of the cable market, and dwarfing its nearest rival. It would also mark a turning point in the consolidation of the entire industry.

The deal is far from secured. In consternation, AT&T promptly declared that it had "no current plans" to sell AT&T Broadband, and that its restructuring plans would go ahead as planned (though it will give the bid "serious consideration"). On July 9th it duly split off AT&T Wireless. Industry watchers suggest that rival bids for its cable assets may yet appear.

Only three years ago, the top three cable-TV companies in America controlled 49% of the country's subscribers. If Comcast's bid succeeds, that figure will rise to 65%. With Comcast's lean operation, strong balance sheet and high-quality cable lines, Ralph and Brian Roberts, the company's father-and-son management team, are hoping to persuade AT&T shareholders that they can run its cables as well as they have their own.

The painful irony for Michael Armstrong, AT&T's chairman, is that it was his own ambition to spread into cable and turn his telephone company into a diversified communications giant that first prompted a rash of mergers in the industry. In 1999 alone, no fewer than 93 deals were announced or completed, covering 29% of all cable subscribers, according to Paul Kagan Associates, a research firm. Mr Armstrong himself has spent a staggering $110 billion buying cable systems; in 1998 he snapped up Telecommunications Inc (TCI), and two years ago he trumped Comcast's bid for MediaOne.

The logic behind all this consolidation seems solid. For one thing, a bigger cable operator has more bargaining power over the price to carry, say, CNN, Nickelodeon or HBO. Since programming represents 40% of any cable operator's costs, driving down those prices can improve margins hugely. Size also helps cable firms to secure, say, the exclusive rights to broadcast a big sports team's games. Combined,

Comcast and AT&T Broadband would have nearly twice as many cable-TV subscribers as AOL Time Warner. As John Frelinghuysen, a media consultant at Booz Allen in New York, puts it: “If you’re the biggest cable operator by far, you become a ‘must have’ for any supplier.”

Furthermore, there are advantages in having geographical clusters of cable customers. Chiefly because of tight regulation, America’s cable systems are fragmented. Simply putting together two contiguous networks can bring down fixed costs. Marketing also becomes cheaper. It is far more efficient to advertise, say, your new high-speed Internet service in a city such as Philadelphia, Comcast’s home town, where most local cable-TV subscribers are hooked up to your system, than it is in Los Angeles, where the subscribers are spread among half a dozen competing systems.

A combined Comcast and AT&T Broadband would be strong in eight of America’s top ten cities, creating for the first time a cable system that began to look like a national network. This would enable the group to offer advertisers, who now need to negotiate lots of deals with local cable operators, a near-national audience. In total, Comcast reckons it can wring out “combination benefits” worth at least $1.25 billion a year.

A third reason for consolidation is the desire to be well-positioned in the race to beam sounds, moving pictures and digital information into people’s homes in the broadband era. Only the bigger groups will have the means both to invest in the technology and to compete with satellite and telephone operators. The cable industry has been piling vast sums into improving its wires. This year alone, capital spending by the top six American cable firms will exceed $13 billion, according to ABN Amro, a bank. Some 85% of Comcast’s cable has been upgraded to what the industry considers high quality, compared with only 65% of AT&T Broadband’s. With the spread of broadband technology, which enables pipes to pump far more stuff into living rooms, the competition to upgrade can only intensify.

Is there any limit to this consolidation? Despite its size, the Comcast deal should be able to surmount regulatory problems. Until now, ownership by any one company has been limited to systems that reach 30% of homes that have either cable or satellite. But earlier this year a federal appeals court overturned this rule, leaving the regulator to reassess the case for such a tight cap. With a looser approach expected under the Bush administration, more mergers are likely.

The bid raises a further, intriguing question: could this be just the start of Comcast’s quest to turn itself into a diversified media empire to rival the likes of AOL Time Warner? Already, Comcast has a fledgling content business: it has a majority stake in QVC, a shopping channel, owns the Golf Channel and controls the Philadelphia 76ers and the Philadelphia Flyers, two sports teams. Certainly, the Roberts duo this week suggested that they saw themselves as far more than mere cable operators.

Welded to AT&T Broadband, Comcast would be of a scale to stand shoulder-to-shoulder with the media giants. AOL, for instance, has 27m Internet subscribers. Yet running a cable utility based in Philadelphia is a far cry from the world of show business that clusters around New York’s Sixth Avenue.

Across the pond

The consolidation does not stop at America’s shores. Although much of the European market remains fragmented, Britain has seen a massive shake-out: only two big cable-TV companies remain, Telewest and NTL. Unlike American cable companies, the British firms make most of their money out of telephone calls. Yet the race to survive in the broadband era—by sending a combination of voice telephony, digital and interactive television and high-speed Internet services down the wires—is similar. This week Telewest and NTL said they will jointly market a broadband Internet service.

Elsewhere in Europe, where cable networks are older than in Britain, there is a veritable jigsaw-puzzle of providers, many of which have run up big debts upgrading their lines. United Pan-Europe Communications (UPC), owned by Denver-based UnitedGlobalCom, has grown chiefly by gathering up cable systems that regulators have forced telecoms incumbents to sell. It is Europe’s market leader, with a presence in 17 countries, yet still has only 10% of all Europe’s cable-TV subscribers.

Even in continental Europe, however, change is afoot. Last month Deutsche Telekom, Germany’s telecoms giant, said it would sell its interests in six out of nine cable regions to Liberty Media, an American giant. This would lift Liberty to the top of the European league, securing it some 20m subscribers. If more proof were needed that further concentration is likely, consider the fact that Liberty’s boss is John Malone, who quit AT&T’s board earlier than he had planned this week, after being cut out of

discussions about the Comcast offer. A counterbid by Mr Malone for AT&T Broadband is now a possibility. Liberty is also the biggest shareholder in UnitedGlobalCom, recently injected *euro*1 billion ($860m) into UPC, and owns 25% of Telewest. Whatever the outcome of the Comcast bid, hungry investment bankers facing lean times can count on the cable industry to deliver them a few deals.

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Corporate downsizing in America

The jobs challenge

Jul 12th 2001 | NEW YORK
From The Economist print edition

How to reduce labour costs without doing more harm than good remains top of the agenda in America's boardrooms

JOB cuts continue to make headlines in the United States. This week, Compaq said it is to shed 4,000 jobs. Together with a 4,500-job cut made earlier this year, that will reduce the computer maker's workforce by 12%. In the first half of 2001, American firms announced around 770,000 layoffs, as many as in any full year during the 1990s, according to Challenger, Gray & Christmas, an outplacement firm.

Behind these awful numbers, America's labour market may be behaving in more complex ways than in previous economic downturns. Companies claim to have learned lessons from past downsizing disasters, and to be trying much harder to keep their "most valuable assets" (see statement of corporate values, if still applicable), or at least to fire them kindly. Is this credible?

In the 1990-91 downturn, many companies cut jobs aggressively and lived (if they were lucky) to regret it. The axe was often wielded with little thought for long-term strategy. Or at least it seemed that way to those who were laid off—and more crucially, to those left behind, whose morale plunged. Generous early-retirement packages tempted many of the experienced employees that firms would, on reflection, have preferred to keep; and, conversely, missed many of those they would happily have lost. When the economy rebounded more quickly than expected, firms had to resume hiring, and those that had cut most aggressively found it harder to recruit.

Geoffrey Love and Nitin Nohria, two economists, studied downsizing at Fortune 100 companies during 1977-93. They found a clear difference between job cuts implemented as part of a strategic restructuring and those done to cut costs in response to stockmarket disappointment at falling profits. The first sort resulted in above-average short- and long-term share performance, the second in prolonged under-performance. This time, firms seem to be responding faster than ever to stockmarket pressure, says Mr Love, though he thinks that their response may be more "strategic", if only because the management consultants they use are stressing the importance of doing something more enlightened than slash and burn.

Certainly, firms have been doing all they can to reduce costs without making job cuts. Memories of how hard it has been to recruit in recent years are fresh. Capital spending has seemed less painful to reduce than jobs, and so has been more ruthlessly cut. Temps now make up a large part of workforces, and it has been easier to stop using them than permanent staff. Attrition, combined with "hiring moratoriums", is the norm. Last week, a quiet work period thanks to the July 4th holiday, several firms in Silicon Valley, including Sun Microsystems, simply shut down parts of their operations and made workers take the whole week as vacation.

This time there has also been more emphasis on managing the morale of those workers left behind after the cuts, most of all by trying to show that the pruning is necessary and fair. A few executives have even shared the pain by taking pay cuts themselves; notable examples are managers at Charles Schwab and at Cisco, whose boss, John Chambers, now works for a symbolic $1 salary (plus lots of rather less symbolic share options). Both firms have tried to soften the blow for those laid off. Charles Schwab, the brokerage's eponymous boss, offered education grants of up to $20,000 from his charitable foundation. Cisco offered to pay one-third of salary, plus full health care and options-vesting, to laid-off workers taking jobs at not-for-profit organisations.

More controversially, firms are doing more to choose those they dismiss—aided by software that ensures they do not fall foul of anti-discrimination laws. Using performance review to "rank and yank" is increasingly common. But it is provoking a backlash from those who doubt its objectivity. This week,

under internal pressure, Ford agreed to abandon its worker-grading system.

So far, job-cutting firms are falling into two camps, the “realists” and the “window-dressers”, says Ron Nicol of the Boston Consulting Group. Too many have been content to make superficial layoffs to please Wall Street analysts, in the hope that they can avoid more painful changes. A tell-tale sign is whether they are reducing the higher-paid head-office jobs that have led the explosion in overheads in the past three or four years. The window-dressers are desperately hoping that the economy will improve soon. If it does not, much larger layoffs seem inevitable.

There are implications in all this for economists trying to interpret the unemployment data. Some are encouraged that the official jobless rate has stayed as low as 4.5%—though there are reasons to think this number is artificially low because adjustments made to reflect unmeasured jobs in new start-ups may now be too big. Unless the economy turns up soon, the pace of job cuts could increase fast.

The jobless rate may jump anyway. In previous recessions, many of the casualties were manual workers who could be fired instantly. This time, the axe is falling more on professionals, who get several months’ notice, help to find a new job and a generous severance package. Such cuts may take a while to feed into the data—especially as many laid-off employees have concluded that they are “between jobs”, that opportunities will soon be plentiful again, and that in the meantime they might as well spend their redundancy pay on a decent holiday. Will there be work for them when they return?

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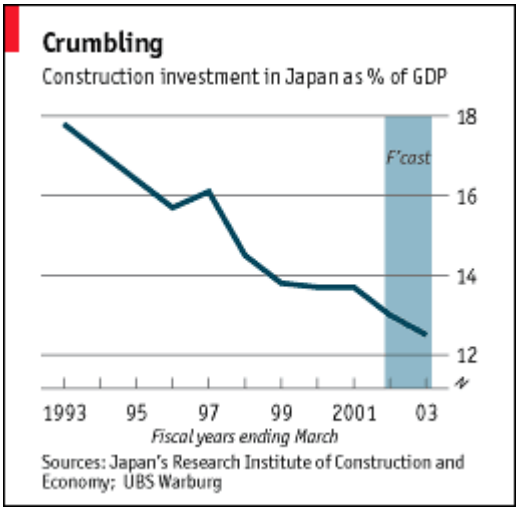
Japan's construction industry

Pass the scaffolding

Jul 12th 2001 | TOKYO
From The Economist print edition

Building companies have too much debt and not enough contracts

SADDLED with massive debts and useless property, propped up by wasteful public-works projects, dependent on links with the Liberal Democratic Party: the construction industry has come to represent all that is wrong with Japan. And now the builders, badly hurt by a decade of low private demand, are being squeezed by a slow decline in public-works projects.



Junichiro Koizumi, Japan's reform-minded prime minister, who sees shock therapy as the economy's salvation, has defied traditional party interests by threatening to slash pork-barrel spending. Plans to build new dams and airports have been frozen. Another 300 or so projects could be stopped. The reforms will hit small and medium-sized builders most, since by law they get preferential treatment when public-works projects are doled out.

Can the ailing industry withstand more pain? It has little to fall back on. Sales and profits are poor. According to Teikoku Databank, a research institute, in the year to March 31st the 113 biggest companies booked a record ¥2.1 trillion ($16.8 billion) of extraordinary losses as they wrote down, or sold, bad assets. Their overall losses for this period were smaller, at ¥389 billion, but only because some of the biggest, such as Kumagai Gumi and Mitsui Construction, were in such a bad way that their banks forgave large chunks of their debts. These debt waivers, which are recorded as extraordinary profits, offset most of the extraordinary losses.

There is growing speculation that wobbly builders will ask for more debt waivers, maybe as early as this month. But this time around, banks will find it harder to agree, says Toshihiko Okino, an analyst at UBS Warburg. Many potential candidates, such as Tobishima Construction and Fujita, are companies that not long ago received similar debt waivers in return for promises to restructure—which they have failed to fulfil. Banks will find it hard to explain to irate, litigation-minded shareholders why they wasted their money on unsuccessful debt waivers before. With no help from banks, some of the worst-run builders may at last go under.

There is plenty of scope for shrinkage. The number of construction companies is still at a record high. Many are paper companies, whose job is to bid for projects, take a cut of the fee and farm everything out to subcontractors. Etsusuke Masuda, an analyst at HSBC Securities, reckons that only half the firms that made money from road-works projects last year are actually able to do road maintenance.

In the meantime, the shenanigans continue. There are rumours that fresh accounting changes expected next year, which would further tighten the way property values are recorded, are being watered down. Some construction companies have used a new, one-off rule that allows them to book profits from ongoing projects to flatter their results. As the outlook for the industry goes from bad to worse, its walking wounded are taking all the help they can get.

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Luxury-goods arbitrage

A different kind of package holiday

Jul 12th 2001 | HONG KONG
From The Economist print edition

Amateur wholesalers are in an upmarket retail store near you

THE same Louis Vuitton handbag costs about 40% more in Japan than in France. To economists, this is a market imperfection begging for arbitrage. And Hong Kong, that bastion of entrepreneurship, is obliging. Here is how.

AP

Spot the genuine customer

Nine Hong Kong Chinese recently spent a fortnight travelling through Europe. They started in Frankfurt and ended in Rome, passing through one city a day. Early every morning, a van picked them up from their hotel and drove them to the first Louis Vuitton store on the day's agenda. It parked around the corner, and the Chinese entered the store in pairs. They each bought as many Louis Vuitton handbags as they could carry and then returned to the van, in order to be transferred to the next store.

It was gruelling work, complains a girl from the van. She, like the rest of the group, went on the trip because it was an all-expenses-paid way to see Europe. (In fact, those who bought more than their quota of handbags even earned a bonus.) But the itinerary did not allow for any sightseeing at all, and for meals the group ate Chinese takeaway in the van. The sales staff in the stores tended to be rude: the tour's "boss", says the girl, had expressly asked for bags "with a certain monogram pattern" that is all the rage in Japan, and one shop simply refused to sell her the nine bags she brought to the counter.

The boss never introduced himself to the group, but when his troops returned he stood nearby in the arrivals hall at Hong Kong's airport, watching them claim their luggage. His business seems to be going well—another tour group is apparently already on the way. Savvy Hong Kong tourists claim to know of several competing organisers—an industry, in other words. Nor is Louis Vuitton the only target: Gucci tours have also taken place.

Should companies whose prices are being arbitraged in this way mind? Louis Vuitton's European sales benefit from such tourism, after all. "We definitely do not think that a sale is a sale," complains an irate spokeswoman in Paris. "It took 150 years to build this brand," she says, and losing part of the retail network to a netherworld of shady Asians damages it. So Louis Vuitton, along with other owners of luxury brands, is working with the authorities to crack down on such tourism. This is tricky, not only because the arbitrageurs tend to pay cash, but also because Louis Vuitton would hate to confuse them with its genuine customers from Asia, who have also been known to binge on bags.

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Iridium

A new orbit

Jul 12th 2001
From The Economist print edition

The ill-fated satellite-phone venture has relaunched itself in more modest form

REMEMBER Iridium, the satellite-phone company whose brick-like handsets were designed to work anywhere on earth? Started in October 1998, it relied on a network of 66 low-orbiting satellites, built at a cost of more than $5 billion. Despite call charges as high as $8 per minute, Iridium hoped to capture a big chunk of what promised to be a vast new market for mobile satellite telephony, which was expected to attract at least 32m subscribers within a decade. The firm spent $180m on advertising, aiming to sign up half a million customers within six months. It was not to be. Nine months after its launch, Iridium filed for bankruptcy, having signed up just 15,000 subscribers.

But now it is back, under new management and with a new business model. The firm's assets were bought by a consortium of private investors last December for the knock-down price of $25m. A deal was struck with America's Department of Defence to provide telephony for up to 20,000 users for $3m a month, which covers 40% of the cost of keeping the system running. Gino Picasso, a former GE executive, was hired as chief executive.

Because the new firm has not had to pay to build its infrastructure and has virtually no debt, says Mr Picasso, it can afford to take a different approach from the old Iridium's. Call charges have been cut to $1.50 per minute, and the company needs to sign up only 65,000 customers by the middle of 2003 to break even. That means it can concentrate on niche markets, such as defence—for instance, providing communications links for peacekeeping forces—and oil and gas exploration.

The old Iridium needed 1m subscribers to break even, which meant going after the general corporate market. But for most business users—with no particular need to call the office from remote jungles—existing mobile phones are perfectly adequate, so this strategy was doomed. Accordingly, Iridium is now being positioned as a smaller and cheaper alternative to existing satellite phones, rather than as a bulkier and pricier alternative to a mobile phone.

Another change in focus, says Mr Picasso, is from voice to data. Originally, Iridium was intended solely for voice calls. But in June it launched a data service that allows access to the Internet from anywhere on earth, albeit at a low speed. A text-messaging service is now available. This opens up new possibilities. One benefit of the satellite-based approach is that it is not affected by power failures or terrestrial disasters such as earthquakes. Already, a power company in California is evaluating the possibility of using Iridium's network to monitor and manage its distribution grid.

It all sounds convincing enough. But the new Iridium's business plan makes sense only because of the utter failure of the old Iridium, which spent a fortune building its infrastructure, discovered that its market forecasts were completely flawed and collapsed under the weight of its debts. Somewhere in that tale, might there be an unpleasant lesson for third-generation mobile-phone operators?

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Public relations

The spin doctors get serious

Jul 12th 2001 | LONDON AND NEW YORK
From The Economist print edition

The financial public-relations industry is coming of age

HOW many PR people does it take to change a lightbulb? “Don’t know. I’ll have to get back to you on that one.” An old joke, perhaps, but apposite until surprisingly recently. The typical London public-relations person of the 1980s did little more than hand out press releases and take journalists to lunch—and was more familiar with the Savoy’s wine list than with his client companies’ strategies.

Reuters

Rubin’s Kosovo experience is now at your disposal

That has all changed. Lunch, this correspondent is happy to report, still definitely plays its part. But today’s spin doctors are sharp-minded professionals, often indistinguishable from investment bankers and lawyers—and increasingly demanding to be paid like them. In America, financial PR (communicating companies’ strategies to shareholders, analysts and the financial press) is still done largely in-house. But it is the top British agencies—Brunswick, Financial Dynamics, The Maitland Consultancy, Finsbury, Citigate Dewe Rogerson and Tulchan—which are showing that financial PR is becoming an industry in its own right.

This change is being recognised by the markets. Over the past two years, big marketing and advertising groups have spent large sums of money buying financial PR firms. Last month WPP paid an estimated £60m ($88m) for seven-year-old Finsbury, which has annual revenues of £8.2m. Last year Cordiant bought Financial Dynamics, while Incepta, which owns Citigate, splashed out $150m on Sard Verbinnen, a top New York PR firm. Among the top British agencies, only Brunswick, the market leader, and Tulchan, a start-up led by an ex-Brunswick partner, are still wholly independent. There are rumours that Brunswick’s flamboyant founder and boss, Alan Parker, is negotiating to sell for £100m to a management consultancy.

What has made PR companies such hot property? The answer is twofold: their relationships and their power. Chris Matthews, head of Hogarth, a mid-sized British agency, claims, with the usual hype, that “financial PR is a Trojan horse to sell other things. We have the ear of the CEO.” That used to be the case with advertising agencies too, he says, but these days “they go through the tradesmen’s entrance.”

Financial PR’s close relationship with the boss reflects the growing importance of spin and image-management to modern companies. Chief executives now routinely spend 30-40% of their time on communications. To keep the share price up, it is no longer enough merely to have a strategy. The strategy also needs to be articulated smartly—as any manager at BT, Ford or Marconi (see article) will tell you.

Senior executives also need PR people to deal with the increasing number of interest groups that scrutinise companies’ behaviour. Shareholders are becoming more demanding and environmental groups more hostile. The rise of online media and the increasing attention that broadcasters pay to financial news mean that companies are having to respond, ideally with carefully crafted and consistent messages, more or less in real time. The consequences of displeasing these various groups can be huge—as shown by the failure of the agrochemical industry to make the case for genetically modified food, or the drug makers’ botched attempts to protect their patent rights in poor countries.

How can a humble PR man deal with all this? One answer is to become more professional. “In the future, PR will definitely be staffed by better trained and educated operators,” says Angus Maitland of The

Maitland Consultancy. Roland Rudd, Finsbury's founder and boss, put his entire team through corporate-finance training to increase their financial literacy, while at Tulchan, account executives are supported by in-house analysts who research clients and their competitors. If not yet exactly sexy, financial PR is becoming at least a respectable option for graduates. It is even starting to attract big names from the political spin-trade. James Rubin, the American State Department spokesman under Madeleine Albright, recently joined Brunswick, bringing the firm valuable publicity.

Sharing in the spoils

Having secured a seat at the top table, PR firms are now seeking financial recognition too. Their top partners have always made a decent living, but now they are starting to close the gap with top lawyers and bankers. A FTSE 100 company in Britain will typically pay its main PR firm £100,000-150,000 a year as a retainer. But the real money comes from crisis work, public listings and mergers, where agencies are, like investment banks, demanding success fees.

Brunswick, which broke through the £1m fee barrier for a single deal with the successful defence of Lasmo against Enterprise Oil in 1995, was paid twice as much last year to fight off Lafarge's first attempt to buy Blue Circle, a rival cement producer. "Retainers are the enemy of value," says Mr Parker. "We want to be paid for results." And with staff as the only big cost, profits can be juicy: Tulchan's Andrew Grant says that any PR company that cannot make a 20% margin is doing something wrong.

PR agencies are following the bankers in another way: they are expanding internationally. This is particularly true of the British agencies, which are moving into continental Europe. As pension reform, deregulation and globalisation create an equity culture on the mainland, French, German and Italian companies are becoming subject to the dictums of shareholder value. And when they look for advice on how to communicate with their new owners, they turn naturally to London. Content at first to fly over for privatisations or cross-border deals, all the big agencies are now starting to open continental offices. According to Andy Cornelius of Citigate Dewe Rogerson, "the complexity of rules governing when a client can talk to media in different countries during a cross-border deal makes PR pivotal."

Agencies are finding that aggressive tactics on this virgin territory can win deals. Earlier this year Citigate helped to defend Sulzer, a Swiss industrial group, against shareholders who were angry about its share-price performance. They used tactics new to Switzerland, including a scorched-earth resignation of Sulzer's chairman, advertisements attacking the shareholders' proposals for a new board, call-centres to rally support and appeals on the Internet. After three months, the shareholders backed down.

British PR firms have had less impact in America, although the biggest are starting to establish offices. American companies tend to communicate more frequently and directly with investors than European companies do; as a result, the financial media is less powerful in America. In addition, most American companies of any size have big and experienced in-house communication teams, so financial PR agencies tend to concentrate on transactions rather than overall strategy.

Although in-house PR is growing in Britain, it seems unlikely to dislodge the hold that the biggest agencies have on their customers. In many industries, British and American managers claim a special relationship. But financial PR is one area where they will continue to do things differently.

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Face value

Deputy heads will roll

Jul 12th 2001
From The Economist print edition

After bungling bad news, Marconi's number two has gone. The boss stays on—but with his reputation shattered

IT WAS, said Lord Simpson, the worst week of his life. There he was, contemplating promotion to part-time chairman of Marconi at next week's shareholders' meeting, and looking forward to spending more time with his golf clubs in his native Scotland. Instead—shareholders willing—he is staying on as chief executive to sort out the mess he created at the British telecoms-equipment company, his reputation in tatters. The man thrown to the bears who have sold the company's stock down to one-tenth of its peak is John Mayo, Marconi's deputy chief executive, who had been groomed to take Lord Simpson's place.

Marconi is being punished for bungling a profits warning. On July 4th, the company suspended its shares all day, something that rarely happens. Wild rumours circulated about its finances. After the markets closed, Marconi gave warning that operating profit in the current year would fall by half. Its excuse for suspending its shares for a whole day was that it was making a positive statement about the sale of its medical business in the morning, and could not allow its shares to trade because a board meeting called for late afternoon was to consider issuing a profit warning. The chairman, Sir Roger Hurn, is said to have resisted calls to bring the meeting forward.

Furious investors sold Marconi when the market opened the next morning, halving its already depressed share price. Shareholders were demanding changes at the top, and before long they got one. Most people assume that Mr Mayo, a pushy ex-investment banker who made his name carving the Zeneca drugs business out of ICI, was fired because he is despised by Lord Weinstock, a big shareholder who built up GEC, as Marconi was known until 1999. Lord Weinstock never approved of the way Lord Simpson and Mr Mayo turned his stodgy but steady conglomerate into a flashy telecoms company after selling off its defence business. But it was the entire Marconi board, including Lord Simpson, who voted out the heir-apparent at a lively meeting on July 6th. Lord Simpson, the great survivor of British manufacturing, will stay on—but only until a successor is found.

An accountant by training, the affable Lord Simpson won a reputation as a safe pair of hands at a number of big British firms, including the Rover car group, where he became chief executive. He is, however, no stranger to controversy.

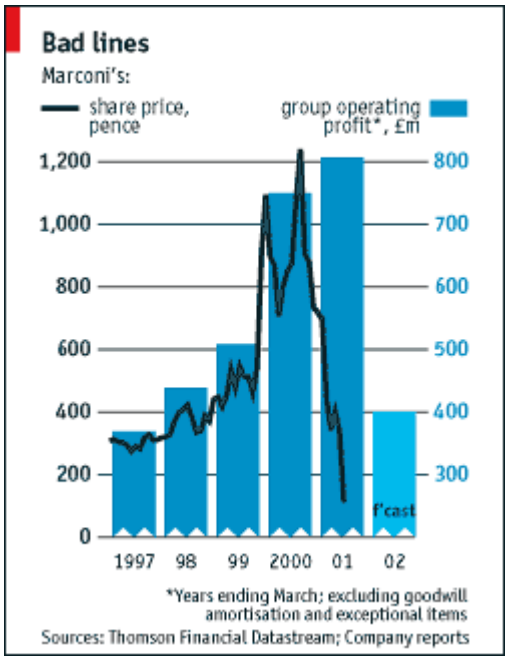
Plain George Simpson, as he then was, became number two at British Aerospace (BAe) when it bought the struggling, state-owned Rover in 1988. Despite the guff about the "sale of the century", Rover was being shuffled off like a hot potato. Still, the deal was a shrewd piece of financial engineering, complete with unusual secret "sweeteners" (from the government) that drew the ire of the competition authorities in Brussels. In essence, Rover's tangible assets were folded into BAe, whose balance sheet had become overstretched. Before long BAe itself was in trouble, as the aerospace market dived.

Another Simpson deal eventually helped rescue it. To the fury of Honda, which owned 20% of Rover, he negotiated a deal in 1994 to sell Rover to BMW, a German car maker (which would later discover that it had bought a used car company). After that deal, Lord Simpson took the helm at Lucas, a car-parts firm. He spent some months trying to work out a strategy for the once-proud British company, before throwing in the towel and selling it to Varity, an American rival. No wonder many expected him merely to switch off the lights at GEC when he moved there, flogging assets and returning money to shareholders.

What went wrong?

He started off true to form, selling GEC's defence business to his old friends at BAE Systems (as British Aerospace had become). That deal alone netted around £6 billion ($9 billion) for shareholders. But, shorn of the steady cashflow from defence contracts, the Marconi butterfly that emerged from the old GEC chrysalis was always bound to be a more fragile creature than Lord Weinstock's cash-rich, cautious conglomerate.

Before long, Lord Simpson, flanked by Mr Mayo, had turned from seller into buyer. He spent some $6.6 billion in 1999 to buy two American telecoms-equipment companies, a mere nine months before the technology boom reached its peak. Unfortunately, since his company was not then listed in the United States, he had to pay cash. The £2 billion cash pile inherited from Lord Weinstock became a £3 billion-plus debt burden—tough for a company whose shares are now worth less than that.



Marconi's top executives always insisted that it was going to be spared the worst of the telecoms meltdown, because its products were at the fancy optical-switching end of the market, and because it was not so heavily dependent as others on the American market. But the chill wind sweeping the industry tore away these claims. Lord Simpson and Mr Mayo were slow both to spot trouble coming and to communicate bad news to investors, culminating in last week's sell-off.

As Marconi bought its way up to number five (from number 20) in the telecoms-equipment world, there was always a suspicion that Lord Simpson's aim was merely to put together a nice pile of assets that could be sold to one of the sector's leaders—such as Cisco, Lucent or Alcatel—near the top of the market. The trouble is that all the potential buyers are swamped by the same wave that swept over Marconi, which is loth to sell at today's low price. Once the market recovers, there is bound to be consolidation, and perhaps a bid for Marconi. But Lord Simpson will by then surely have ended his career and be spending his days on the links.

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Mass customisation

A long march

Jul 12th 2001 | SOLIHULL, ENGLAND, AND NEWTON, IOWA
From The Economist print edition

For years "mass customisation" has been the holy grail of manufacturing, building to meet customers' individual orders rather than for stock. Progress is proving slow, but the journey is illuminating

HENRY FORD launched mass production 88 years ago with his revolutionary assembly line for the Model T car. It proved a brilliant system—at least, for as long as there were customers waiting at the end of the line to drive Ford's cars away. But it lost some of its shine when customers became harder to find, meaning that mass-produced cars sat expensively in parking lots and showrooms. Now a new dream is at hand: to turn mass production on its head with the help of flexible systems and Internet ordering. The goal is to deliver precisely the car that a customer wants, as and when he wants it: goodbye inventory, hello "mass customisation".

As with cars, so with washing-machines, refrigerators, window-frames, packaging equipment and even collectable dolls. All sorts of companies are discovering that, if they make their factories lean and flexible, they can run their businesses differently, freeing idle capital that has been tied up in stocks of parts and finished products. The Internet has provided a handy means of linking up supply chains, in real time, in order to put this revolution into effect.

Mass customisation—the selling of highly individual products but on a mass scale—is a logical next step in the progress of BTO ("build-to-order"), the manufacturing of goods only as and when there is an order from a customer. Companies such as Dell Computer and Renault already make extensive use of BTO systems, shortening delivery times and trimming work-in-progress. In essence, they are taking the lean manufacturing techniques that western firms have spent the past 15 years copying from Toyota in Japan, and extending them throughout their "value chain", both upstream and downstream of the factory. And that means turning a production-push industry into a demand-pull one.

The chairman of Renault, Louis Schweitzer, has declared that Renault's ambition is to build and deliver a car ordered by a customer within 15 days. "It is the dream we are all running after," says Roberto Testore, the chief executive of his Italian rival, Fiat Auto, "but it is difficult to bring to reality."

Move the metal

The prize to be won in the form of lower supply-chain costs is enormous. A recent study by a group of consultants at McKinsey* put a figure on the amount that is lost by producing cars to meet a demand that never materialises. Eliminating such losses (and the associated discounts needed to sell off excessive stocks of finished cars) could, according to McKinsey, be worth up to $80 billion a year to the car manufacturers. Nissan Motor has estimated that converting entirely to BTO could save up to $3,600

per vehicle. Nevertheless, despite some concerted efforts, notably among car makers in Europe, the goal of the “three-day car” (as one research project dubs BTO vehicles) could still be ten years distant.

Ever since Henry Ford battled with Alfred Sloan’s General Motors for leadership of the car industry in America in the 1920s, the watchword in Detroit has been “move the metal”. Models would be mass produced in batches of different colours, or with different trims and options, based on the best guesses of the marketing department as to how many of each variant could be sold. Big car manufacturers became adept at leaning on dealers to absorb vehicles (even offering them up to 30 days’ free credit) and encouraging them to sell below list price if they were overstocked.

No industry epitomises the traditionally gaping gulf between producer and consumer quite as clearly as the car industry. The tensions in a car showroom—between the salesman who wants to sell what he has in stock and the customer who wants to buy what he has in mind—make buying a car one of the least enjoyable of all consumer experiences.

The salesman for a dealership in mass-market cars has to make some three sales a week to earn his wages. But dealerships are not thronged like food stores. So when somebody actually comes through the door, the salesman is desperate to close a deal, even if he does not have the version of the car that the customer is actually looking for.

The mass-customisation zealots think that all this can be changed, creating a world in which consumer satisfaction and producer profits rise steeply together, as systems become more agile and faster. Everybody looks at how Michael Dell dethroned Compaq, the PC-industry leader, with the simple business model of direct sales over the telephone and the Internet. The Dell customer specifies what features he wants on his PC and pays upfront by credit card. The machine is then assembled and dispatched, usually arriving within three days.

Yet the real secret of how Dell Computer manages this trick lies in the way that it restricts its computers to several key modules, and stocks a variety of each, allowing a wide choice of customer specification. In fact, Dell PCs can be put together in about four minutes flat, with a further 90 minutes needed to load up the software. Most of the customisation comes from the software that is chosen.

The essence of BTO production is to have standard pre-assembly of such modules, which are then configured at a late stage in the manufacturing process. Dell has to be sure that suppliers can respond quickly and furnish the necessary quantities of the modules that are in demand. Leaving the customised bits to the end of the assembly process helps to reap some of the benefits of mass production while offering individual specification and rapid delivery to a “customer of one”. This formula, the antithesis of the mass market, has allowed Dell to grow by 40% a year in recent years, even as the PC industry as a whole has been growing by only 15-20%. Last year, Dell replaced Compaq as the world’s biggest PC maker.

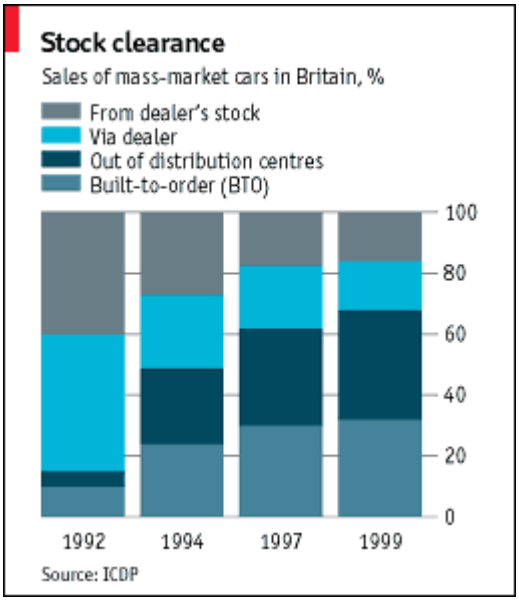
Computers are not the only consumer product for which lead times to delivery have shrunk. Photographic development is another, going from five days to one, or even to one hour for premium services in which the job is done in special mini-labs rather than in the big photo-processing factories of yore. Another is spectacles: some retailers can now deliver individually tailored lenses within an hour.

In these cases, the key enabling development has been the arrival of production methods that allow manufacturing to be farmed out to small, local sites—ie, the shops themselves. Some lean-production experts, such as Anand Sharma, the founder of TBM Consulting in North Carolina, think that one consequence of building to order rather than for stock will eventually be a change in the geography of traditional manufacturing. Mr Sharma foresees the rise of “distributed manufacturing” with, for instance, fewer giant plants and more small ones assembling from pre-fabricated modules closer to the end-user.

The three-day car?

There has been a big change within the car industry in the way that orders are handled. According to some recent studies, around 19% of cars ordered in Europe are custom-made, compared with barely 7% in America. But the proportion that are built-to-order (though not necessarily customised) in some countries is a lot higher: in Germany, some 60% of cars are now built in response to customer orders placed directly or indirectly with the factory. A study in Britain shows that BTO cars rose from 10% of the total nine years ago to 32% in 1999 (see chart).

Some 40 car companies and parts makers have set up a forum called the International Car Distribution Programme (ICDP) to look into ways to streamline the distribution and sale of cars. Based near Birmingham, England, ICDP brings together businessmen and academics from across Europe to plot exactly what goes on in this area, to study consumer reactions and to find ways of improving performance. The aim is to find out how to supply and please more customers at lower cost.



This has led to an associated study involving such car makers as Volkswagen, Ford, General Motors, Nissan, Honda and Peugeot. Known as the "3DayCar" project, this explicitly sets out to see if the Dell Computer model can be applied to car making. The team working on it is a mixture of economists, distribution experts from other industries and former car-company managers who know how traditional car distribution works.

The project director, John Whiteman, points out that most consumers who order a customised car are used to waiting 50-60 days for it to be built and delivered. As he says, "that shows how well they have been conditioned by the manufacturers." Customers often identify delay with quality. In practice, says Mr Whiteman, "it takes no longer to build a BMW than it does to build an ordinary volume model." This different expectation allows BMW to benefit greatly from its flexible production lines.

Analysis by Mr Whiteman's team has shown that out of the 42 days of order-to-delivery (OTD) time for a typical volume car, actual production takes only two days, with a further five for delivery from factory to dealer. The rest is all taken up with handling paperwork, scheduling parts and determining a slot in the manufacturing process.

The team's research across Europe suggests that customers would like to take delivery of the car they order within one or two weeks. In Spain, according to Fiat's Mr Testore, if a dealer cannot promise a car within two weeks, customers tend to shrug and go elsewhere. Some manufacturers, notably Renault, are speeding up their production and ordering systems so that customers can get whatever they want in less than 14 days. If you order a Renault you can make alterations to the specification, colour and options, via a Renault dealer, up to 14 days before the scheduled delivery date.

The downside of applying BTO to an industry such as car making is that consequent peaks and troughs in demand threaten to make a mockery of mass manufacturing. As the McKinsey paper points out, most car factories do not start to make profits until they are working at 80% capacity. Fluctuating production leads to inefficiency as factories reduce output in slack periods.

For that reason, McKinsey argues that BTO is a will o' the wisp for car companies. Its consultants suggest that "virtual" BTO is the real answer. That means exploiting the Internet to find the whereabouts of a car that matches an individual customer's personal requirements somewhere within the existing distribution system.

That way, customers get what they want sooner and inventory turns over faster—but without losing the benefits of mass production. Car companies, the authors argue, have better things to do (such as ensuring that they make cars that actually appeal to consumers) than turning their manufacturing and distribution processes upside down.

In fact, car companies in Europe have been doing this virtual BTO for years. They have set up regional distribution centres at which buffer stocks are held for dealers to draw upon. Such centres are largely responsible for the rise in the 1990s in the proportion of car buyers who get the exact specifications that they want—in Britain, it has gone up from 25% to 76%.

The ICDP "3DayCar" team thinks that the trend is inexorably toward greater and speedier consumer gratification. But its research suggests that not all consumers want their cars within three days, even if that were feasible. In reality, they have widely varied demands when it comes to timing. Fleet buyers, for example, have programmed orders that stretch out into the future and can help car companies to plan their production schedules. Other customers fall somewhere in-between. The way to smooth demand, therefore, is to use price discrimination to even out the peaks and the troughs. Rather than offering heavy discounts to move stocks of cars that are piling up on the showroom forecourts, incentives could

be used to bring in orders for different waiting times. This is more or less what airlines do when they sell seats on flights.

One of the biggest hurdles in the path of the three-day car is the paint shop, which is traditionally an expensive bottleneck in the car factory. Changing from one colour to another causes such a bother that car makers tend to run big batches of vehicles in one colour at a time.

The only way round this is the sort of system that is used to make little Mercedes Smart cars. They have metal frames on which are hung coloured outer panels. This allows the customer to alter the colours later if he does not like his original choice. Other companies, such as Fiat and Audi, have been using similar frame construction methods for some of their models, rather than the conventional monocoque bodies that are welded together from stamped steel panels.

Follow that washing machine

The car industry may be the pioneer, but many other manufacturers are also looking for ways to reduce stocks. “American business is full of piles of inventory,” says Bill Beer, the boss of the biggest part of Maytag Corporation, its appliances division, which is based in rural Iowa. “I see it as an overhead conveyer belt with lots of $100 bills hanging from it. My job is to pull down those bills.”

Faced with fierce competition from companies such as General Electric and Whirlpool, Maytag has chosen to make fancy washing-machines, dishwashers and refrigerators that sell at around three times the price of mainstream products. This means that there has to be a wide range of choices, putting a premium on flexible manufacturing systems that can keep up with demand.

Mr Beer’s plan to grab the $100 bills is to move as close as he can to BTO. He sees three steps along the way. At the bottom is old-fashioned “build-to-forecast”; at the top is “build only against customer order”. In the middle, which is where Maytag is today, is “build-to-replenish”—ie, as soon as one product is sold, start to make another. “The idea is that the product does not go down the line until the cash register rings in a store. The real trick is to organise yourself so that your supplier and your supplier’s supplier also hear that ring.”

To get anywhere near such a taut, demand-pull supply chain, Mr Beer and his two manufacturing lieutenants (both from the motor industry, as it happens) have, with the help of TBM, devised a combination of lean manufacturing and quality-control techniques. The lean approach is standard: to install quality and cut waste through piles of inventory along the line. The quality-control work uses statistical tools to track the occurrence of faults and to spot even the tiniest variations in the processes. Divergences from standard procedures are what usually create faults.

Walking around the floor of Maytag’s washing-machine factory in Iowa is like a lesson in modern industrial archaeology. There are three levels of sophistication on show. One part of the factory makes a traditional basic model in a traditional manner, with one long assembly-line conveyer belt and lots of offline areas in which faulty machines are taken out of the loop for repair. A second line, making more sophisticated products, has a number of smaller production cells instead of a long line, and only a few offline repair areas. Instead of a conveyer belt, machines come along on little pads that stop them at each station for a while. So far, so traditional.

But the third production area, making the most advanced Atlantis washing machines, consists of just seven cells. In these, groups of workers make whole boatloads of washers, which come off the line at the rate of one a minute. The work is less mindless than performing single repetitive tasks, and each operator can see what is going on around him. That means he can stop the line if something is wrong, or move along to help a buddy at the next station when needed. Working in such small cells means that no time is wasted by workers looking around for parts. “Everything is brought to the worker, as if he were a surgeon,” says Art Learmonth, one of Mr Beer’s manufacturing lieutenants. The cell arrangement is also more flexible than one long line, in that seven different variations of a washing machine can be turned out at the same time.

A similar reworking of the company’s Jackson, Tennessee, dishwasher factory improved quality by 55%, cut work in progress by 60%, freed up 43,000 square feet and increased capacity by 50%. Such factories can now turn out any model at any hour of the production day, in response to feedback from the department stores that sell Maytag’s products.

This “build-to-replenish” model is a key stage on the way to full-scale BTO, which Maytag has already introduced for some of its top-of-the-line refrigerators. Although it has not got there yet, the company’s aim is to “sell today what we make tomorrow,” says Mr Beer.

For Maytag, as for companies in the car industry and elsewhere, genuine mass customisation may still be a long way off. But the journey towards it, via the staging post of BTO, is teaching companies a lot about how to eliminate waste—of both time and materials. This may be a case where travelling hopefully matters almost as much as arriving.

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* “The False Promise of Mass Customization”, by Mani Agrawal, T.V. Kumaresh and Glenn A. Mercer. *McKinsey Quarterly, 2001 Number 3*.

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The dollar

The greenback's charm

Jul 12th 2001
From The Economist print edition

Investors remain smitten by the dollar. How much longer will their passion last?

Get article background

LAST week, at a bank's strategy session ahead of a meeting by the European Central Bank to set interest rates, currency traders weighed up the euro-dollar exchange rate. If the ECB cut interest rates, they decided, the euro would fall, because it would have been pushed by outside pressure and forced to turn a blind eye to inflation. But if the ECB kept interest rates unchanged (as it actually did), traders bet that the euro would still fall, because the bank would be choking European growth. The market, it seems, is so infatuated with the dollar and scornful of the euro that the ECB's policy makes no difference.

The euro duly did fall last week, to below $0.84, within a whisker of its October 2000 all-time low since its launch in January 1999. The dollar has since lost ground, but it still stands roughly 10% higher, against both the euro and the yen, than it did at the end of last year. It is now worth almost 40% more in euros than it was when the single currency was introduced. The dollar's real trade-weighted value (a measure of competitiveness, adjusted for inflation differentials) against 55 developed and emerging-market currencies is at a 16-year high (see chart).

Until last year, the dollar's vigour could be justified by the strength of America's economy, which had attracted large inflows of capital chasing high returns. This explanation still fits the dollar's climb against the yen this year, as Japan's economy is now in recession and America's is still growing, albeit slowly. But the greenback's continued rise against the euro is more of a puzzle.

In its latest *World Economic Outlook*, the International Monetary Fund tries to explain the movements of currencies over the past decade by analysing all the data. It concludes that the three most important determinants of the dollar's swings against the euro (or against the euro's component currencies before 1999) have been relative expected growth rates, bond-yield differentials and net equity portfolio flows.

On this basis, the dollar should have fallen this year. After all,

growth has slowed more sharply in America than it has in the euro area. Last October *The Economist*'s poll of forecasters found that GDP was expected to grow in 2001 by 3.5% in America and by 3.1% in the euro area. Those figures have since been revised to 1.6% and 1.9% respectively. Interest rates have also moved against the dollar. Short-term rates are now lower in America than in the euro area, and the yield premium on American bonds over euro-area bonds has been all but eliminated. Last, but not least, American equities are no longer offering such juicy returns, with the S&P 500 down by 23% from its peak last year.

In recent years America's large current-account deficit has been more than willingly financed by portfolio and foreign direct investment (FDI). But now that American growth has slowed, profits are falling and equities have slumped, why have investors kept their appetite for dollars? Inflows of FDI into America have fallen this year, but portfolio inflows (both equities and bonds) remain strong. America's slowdown has not shaken investors' belief that, over the longer term, America will offer faster productivity growth and hence higher rates of return than Europe.

International investors are still betting on America's "new economy" and the skill of Alan Greenspan, the Federal Reserve chairman. Their belief that Europe remains riddled with rigidities and is unlikely to change much has also been reinforced by recent developments, such as the European Commission's veto of the GE-Honeywell merger and the European Parliament's rejection of an EU-wide takeover code. In the opinion of American currency traders, "Europe still doesn't get it."

Bucks fizz

The dollar's real trade-weighted index*
J.P.Morgan, 1990=100

Exchange-rate forecasts

	$ per euro	Yen per $	$ per £
Rate July 10th	0.85	125	1.41
Forecast‡ for Dec 2001 made in:			
Dec 2000	1.01	103	1.54
latest	0.89	126	1.43
Forecast‡ for June 2002:			
latest	0.93	122	1.45

*Based on 55 currencies, adjusted for inflation differentials
†July 2001 ‡Average of Goldman Sachs, HSBC, J.P. Morgan Chase, Morgan Stanley, Salomon Smith Barney, UBS Warburg

That verdict is somewhat unfair. The single currency is boosting competition and encouraging firms to exploit economies of scale through mergers. With the help of some labour-market reforms, this should lift productivity. However, a study by the Bank for International Settlements finds clear evidence that currency markets react asymmetrically to economic news about the euro. The euro tends to weaken against the dollar in response to disappointing data in the euro area, but fails to rise when the news is favourable. In other words, there is a persistent negative market sentiment towards the euro.

Most currency forecasters still expect the dollar to fall a bit against the euro over the next year, but by much less than they once did. Last December six banks polled by *The Economist* had an average forecast for the euro-dollar rate of $1.01 by the end of 2001. Their latest average forecast is for a rate of $0.89, and two of the six banks expect the euro to fall to a new low. Even by mid-2002 their average forecast is just $0.93. Only one bank, Goldman Sachs, expects the euro-dollar rate to rise above parity within the next 12 months. Our panel have cut their end-year forecast for the yen even more dramatically, from ¥103 to the dollar last December to ¥126 (see table above).

Wim's wisdom

Most economic studies suggest that the dollar is overvalued against the euro and, to a lesser extent, against the yen. American manufacturers are already squealing, and they are not alone. Sir Edward George, governor of the Bank of England and chairman of the group of G10 central-bank governors, said this week that a strong dollar was hurting not only America but the entire world economy.

In Europe, for instance, the weak euro is pushing up inflation. This, in turn, squeezes real incomes and hence consumer spending, and it is forcing the ECB to delay cutting interest rates. The strong dollar is also putting pressure on emerging-market currencies. Argentina, which pegs its peso to the dollar, faces rising debt costs. Fears about a default are having severe knock-on effects on other emerging economies, such as Brazil (see article). Both in Eastern Europe and in Asia, currencies are tumbling against a strong dollar.

Wim Duisenberg, the president of the ECB, seems however not to believe that a strong dollar is such a threat to the world economy. He said this week that he was not concerned about the weakness of the euro against the dollar. The ECB's critics immediately leapt upon this as evidence that he lives on a

different planet.

Yet he may be right. John Makin, an economist at the American Enterprise Institute in Washington, argues that many countries could not cope with a weak dollar on top of a slump in American demand. In a fragile global economy, says Mr Makin, a weaker dollar would be a bigger problem for the rest of the world, as it would let America export more of its recession to others. Japan, in particular, needs a weak yen to fight off deflation. Mr Duisenberg may have been foolish to speak his mind, but that does not mean he was talking nonsense.

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The UN's human development report

Let them eat more

Jul 12th 2001
From The Economist print edition

Technology and innovation can help the poor as much as the rich

THE anti-globalisation brigade likes to tout two big objections to new technology's role in promoting growth. The first is that the richer you are, the more access you have to technological innovation; information technology, in other words, reinforces the "digital divide" between rich and poor. The second is that unwelcome western innovations—such as genetically modified food—are shoved on people in poor countries, who gain no benefit from them. The United Nations' annual *Human Development Report** this year tackles these objections head-on. By looking at the relationship between technology and growth, its authors come to a convincing conclusion: poor people need more innovation and access to technology, not less.

EPA

He wants to modify his wheat

The evidence that technology helps development is strong. The decline in mortality rates that took more than 150 years in the now-developed world took only 40 years in the developing world, in large part thanks to antibiotics and vaccines. Technological innovations in plant-breeding, fertilisers and pesticides have doubled the world's cereal output in a mere 40 years, compared with the 1,000 years that it took English wheat yields to quadruple. More recently, the development of oral rehydration packets, a simple solution of sugar and salt that increases the absorption of liquids, has cut the cost of treating diarrhoea and saved millions of lives.

The problem remains that the great majority of technological advances are produced by, and for, rich countries. In 1998, nine-tenths of new patents went to OECD countries, home to only one-fifth of the world's population. Of the $70 billion spent on health research in 1998, a mere $100m went to malaria research.

In the unequal distribution of technology, there is market failure, both national and global. The report's recommendations fall into two categories: what poor countries themselves can do, and what should be done multilaterally. At the country level, the report stresses proper incentives to invest in research and development, with a greater emphasis also on education. Rich countries subsidise R&D, because the benefits of new technologies to society as a whole are greater than those realised by the companies that produce it. By contrast, poor countries spend very little on subsidies for R&D—only 0.6% in South Asia and Latin America, for instance, compared with 2.4% of GDP in the rich world.

Good research, though, demands a critical mass of well-educated workers. Here, the report treads delicately. Traditionally, the approach to human development has been guided by a "trickle-up" philosophy. The social returns from investment in primary education, for example, are higher than for secondary or tertiary education, with the benefit that they tackle poverty directly. Ditto, returns from investment in primary health care and preventive medicine over investment in modern hospitals and curative medicine.

In their push for more R&D in poor countries, the authors want more spending on higher education, but without a retreat from primary education. Their recommendation to retain public funding for primary education, while encouraging the private supply of higher education, is thus probably on target.

At a global level, the report calls for more public funding and for a "reassessment of the rules of the game" to ensure that the deck of technological innovation is not stacked against poor countries. Just as

innovators do not fully recoup the social value to a country of new technologies, so countries do not recoup the social value to the rest of the world of their innovations. Since the benefits of R&D spread across borders, countries tend to under-invest in R&D from a global perspective. For this reason, the report advocates a global initiative to establish research partnerships between rich and poor countries.

With luck, this will encourage research on problems that matter to the developing world. In the meantime, the report should make well-off protesters who vandalise plantations of genetically modified maize think twice about whether they are actually helping the poor.

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* *Human Development Report 2001*: “Making new technologies work for human development”. UNDP, 2001.

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Banking in Britain

Ellwood Agonistes

Jul 12th 2001
From The Economist print edition

Lloyds TSB needs a new strategy, fast

PETER ELLWOOD, chief executive of Lloyds TSB, keeps a well-thumbed copy of Clausewitz's "On War" in his office. It helps him, he says, to think about strategies for future conquests. So far, though, Mr Ellwood's own warlike attempts have fallen flat. This week, Patricia Hewitt, the trade and industry secretary, accepted a recommendation of the Competition Commission and blocked Lloyds TSB's £18 billion ($25 billion) bid for Abbey National. This puts an end, in effect, to further consolidation among big banks in Britain.

The commission had concluded that a merger between Lloyds TSB, the third-biggest bank in Britain, and Abbey National, the sixth-biggest, would reduce competition in personal current (checking) accounts and in banking services for small businesses. In current accounts, Lloyds TSB and Abbey National together would have controlled 27% of the market, higher than the commission's favoured ceiling of 25%. Various remedies offered by Lloyds TSB, such as lowering interest rates on current-account overdrafts or selling up to 50 branches, did not soothe the commission.

Although Abbey National has only tiny market shares in current accounts and small-business banking–5% and 1% respectively–the commission also reasoned that to allow Lloyds to swallow the smaller bank would eliminate a promising future competitor. In this, it betrays a deep mistrust of the "big four" British banks. Earlier this year it ruled that they operate a "complex" monopoly in the supply of banking services to small and medium-sized businesses. By the end of the year it will say what, if anything, it wants to do about it.

With Lloyds TSB off its back, Abbey National now has an acquisitive eye of its own. "We've gone from being a tasty morsel to the top of the food chain," says one of the bank's advisers. Wishful thinking, perhaps. By proposing a merger with Bank of Scotland last year, Abbey National conceded that it needs a partner. The Competition Commission's judgment may protect it from big British rivals. But Abbey would face fierce competition if it tried itself to pick off smaller British banks, such as Alliance & Leicester. And an attack could still come from abroad: National Australia Bank, for one, is sniffing around.

As for Lloyds, Mr Ellwood now claims that acquiring Abbey National was never a strategic imperative. His bank's real future, he says, rather vaguely, lies in an overseas deal, preferably a European merger of equals.

That will be hard to bring off. Lloyds TSB has been looking for a partner for years. Under its former chairman, Sir Brian Pitman, who was a loud champion of shareholder value, the bank became known as a machine-like destroyer of jobs and senior management. Disdaining such a vigorous Anglo-Saxon approach, most European bank bosses would probably prefer deepening alliances on the continent, inside the euro zone. Mr Ellwood could try buying a series of smaller European banks, but this would take time to have any great impact on earnings.

Abbey National would have offered a fast and easy way for Lloyds TSB to raise profits by cutting costs. As it is, revenue growth remains a headache for Lloyds TSB. Last year revenues in retail banking grew by just 2%, while costs grew by 7%. This is a problem that Mr Ellwood's shareholders will now demand he tackle, whether with a European venture or in some other way.

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Crédit Lyonnais

Management by committee

Jul 12th 2001
From The Economist print edition

New details about the Executive Life affair

CREDIT LYONNAIS, a French bank, has consistently maintained that wrongdoings over the purchase in 1991-93 of Executive Life, an American insurance company, did not come to the attention of Jean Peyrelevade, the bank's chairman since November 1993, until the end of 1998. The bank faces criminal proceedings and is a defendant in several civil lawsuits in America over Executive Life.

This week, *Le Nouvel Observateur*, a French magazine, reported new details about the affair, based on testimony from Dominique Bazy, formerly Mr Peyrelevade's right-hand man. Mr Bazy's evidence casts light on a 17-page internal fax sent on December 10th 1993 to Mr Peyrelevade's office. Mr Bazy says he was the intended recipient of the fax, which contained explicit details of the fronting arrangements entered into by the bank to get round American federal and state laws when it took over Executive Life. Mr Bazy and François Gille, a fellow joint number two, both read the fax. Mr Peyrelevade claims that he did not become aware of its contents until 1999.

After Executive Life went bust in 1991, insurance regulators opted for a rescue package put together by Crédit Lyonnais. As part of the package, the bank arranged for a new insurance company, Aurora, to take over Executive Life's insurance contracts. Regulators were told that the consortium set up to own and manage Aurora would be independent of Crédit Lyonnais, as both federal and state laws required.

However, members of the consortium of "independent" shareholders in Aurora, led by MAAF, a French insurer, were in fact fronts for Crédit Lyonnais. The bank had confidential agreements to buy back shares in Aurora from consortium members. The bank also arranged in principle for Artémis, controlled by François Pinault, one of France's richest businessmen, to buy shares in Aurora from the consortium of investors so that the fronting scheme could be unwound.

As well as explaining the Executive Life deal, the 17-page fax also described the bank's relationship with Artémis. This was hardly surprising, as, according to Mr Bazy, the bank's executive committee, which comprised Mr Peyrelevade and his three lieutenants, met on December 13th (minus Mr Bazy) with the sole purpose of discussing the nature and scope of the bank's relationship with Mr Pinault. According to *Le Nouvel Observateur*, Mr Pinault telephoned the bank later the same day to give an irrevocable undertaking to acquire a controlling interest in Aurora from consortium members.

This does not prove that the executive committee discussed the fronting arrangements. But it suggests that they must have done. Without a discussion, the top managers, including Mr Peyrelevade, could not have formed a complete picture of the risks associated with the bank's relationship with Mr Pinault.

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About sponsorship

Japanese banks' bad loans

Dead, or just resting?

Jul 12th 2001 | TOKYO
From The Economist print edition

Suspiciously few loans are counted as truly awful

FULLY committed to painful structural reform: so Masajuro Shiokawa, Japan's finance minister, promised he was when he met his counterparts from other G7 countries at the weekend. Topping his list of reforms is getting banks to dispose of the very worst of their bad debts, which, under official guidelines, come to around ¥13 trillion ($104 billion). If banks do this, some of their weakest borrowers will be thrown into bankruptcy, with an inevitable and overdue shake-up of ailing, overcrowded industries, such as construction and retailing, to follow.

These ¥13 trillion of loans, to companies now classified by banks as either bankrupt or in danger of bankruptcy, are but the tip of a ¥150 trillion iceberg. With so much talk of serious reform by the government, supporters hope that, at the least, the move will help tackle some of the corporate wounded that must surely have been included in these categories.

In reality few, if any, big borrowers have been placed in these deadbeat divisions. Rather, these categories are stuffed with small and medium-sized companies, whose demise will not badly damage the industries to which they belong. Since banks are bound by confidentiality rules and do not disclose details of individual borrowers, it is impossible to know for sure who is included in these categories. Anecdotal evidence from the large banks suggests that big, wobbly companies have, so far, little to fear from a clean-up of the banks' bad loans.

In fact, they have been defended to the hilt. Look at Asahi Bank, which is itself in danger of having its "financial strength" downgraded to "E", the worst possible rating, by Moody's, a credit-rating agency. Weeks before it had to close its books at the end of March, it was locked in debate with the Financial Services Agency (FSA) over how to rate Aoki, one of Japan's battered construction companies. In 1999, Aoki had ¥205 billion of interest-bearing debt waived by banks, in return for setting up a 20-year restructuring plan. In March it had that much and more sitting on its books. Like many other construction companies, it is struggling to raise its sales and profitability.

The FSA argued that a 20-year restructuring period was too long to be convincing, and that Aoki should be classified as being "in danger of bankruptcy". In the end, however, Asahi seems to have won, and Aoki is rated as merely in need of monitoring. Investors disagree. Aoki's shares are currently trading at around 25% below their face value.

Similar discrepancies abound elsewhere. According to a document leaked to *Shukan Bunshun*, a news magazine, Fuji Bank, Dai-ichi Kangyo Bank and the Industrial Bank of Japan (IBJ), which have linked up to form the Mizuho Financial group, found some startling differences in their classification of borrowers when they got together. For example, Fuji had classified Hazama, another troubled builder to which it had little exposure, as in danger of bankruptcy. Dai-ichi Kangyo and IBJ, on the other hand, had placed it in a less risky category. As it happens, both banks had lent large amounts of money to Hazama. Now it seems that all three banks, like others in the industry, have decided that, since it recently had a chunk of its debt wiped out, Hazama (whose shares are trading below par) should be considered a "healthy" borrower. Mizuho says that the leaked document is not genuine.

Mycal and Daiei, two struggling supermarket giants, also appear to have been kept out of the worst two categories of debt. Despite persistent talk that they are highly vulnerable, most banks seem to be happy that their debt is secure. The capital markets are less certain. One of Mycal's bonds, due to mature in 2008, is now priced at ¥33, a third of its face value. Investors would still, in theory, be able to get the full ¥100 a bond if they held on to maturity. That they are scrambling to sell (the price of these bonds has halved in the past two months) suggests they are afraid either that Mycal might not be around in 2008,

or that it will default on its debt before then.

Why do the banks seem so optimistic in the face of such market pessimism? One reason is that they cannot afford to be more cautious. Banks have to set aside reserves for only 15% of a loan that is “in need of monitoring”. Reclassifying a loan as “in danger of bankruptcy” would mean reserving against 70% of the loan instead. The bigger the borrower, the bigger the hit, and some banks, already hurt by a sliding stockmarket, might find it hard to meet capital-adequacy requirements if they reserved more against big borrowers. Others might even be unable to make dividend payments on preferred shares owned by the government—putting them at risk of, in effect, being nationalised.

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About sponsorship

Ethical investment

Warm and fuzzy

Jul 12th 2001
From The Economist print edition

The trouble with "ethical" investment is the woolliness of its principles

EVEN the world's largest and second-largest pension funds are at it. ABP in the Netherlands announced this week a "socially responsible" investment of $200m. Calpers, the pension fund for California's public-sector workers, recently said that it would run its emerging-market portfolios in an "ethical" manner. What started as a fad for idealists has now become a mainstream idea debated by pension-fund trustees, fund managers and company executives.

Many remain sceptical about so-called socially responsible investment (SRI). Ostracising wicked companies does not reform them, these sceptics say. Besides, what is the moral framework? Is a company which produces drugs that save lives a responsible company, even if it does not slash its prices in poor countries as much as some activists would wish? And is testing its products on animals, as practised by Huntington Life Sciences, a long-running target of activists in Britain, socially responsible or irresponsible?

Received wisdom suggests that socially responsible investment tends to underperform the market. But this is not always the case. The Domini social equity fund, for instance, did better than the Standard & Poor's 500 index for the three years up to 1999, though it fell back last year.

One reason for this might be that such indices are over-weighted in favour of "clean" technology companies, which shone during the late 1990s. In principle, though, sound social and environmental policies, which often go hand-in-hand with good corporate governance, could be profit-maximising. Good treatment of workers can translate into higher productivity. Energy conservation can save costs. "Today, SRI is as much about generating good returns as it is about a company's environmental and social benefits," claims Diana Propper de Callejon at Critical Resources, a venture-capital fund that invests in environmentally benign companies.

Still, the fuzziness of the concept remains a problem, even though funds draw up rules for "screening" companies. Fund managers at Bank Sarasin, a private bank and one of the early ethical investors in Switzerland, shun some sectors, including tobacco and nuclear power, when they select companies for responsible investment. Yet they make exceptions: they invest in BP Amoco, for instance, even though fossil fuels are seen as dodgy.

The fuzziness also explains the uncertainty about quite how much money is parked in ethical funds. According to the Social Investment Forum, an American non-profit organisation, SRI in America passed $2 trillion in 1999—one in every eight dollars under management. This seems implausibly high. Fidelity, America's largest mutual-fund firm, with about $1 trillion under management, lacks an SRI fund. Vanguard, another American giant, rolled out its social-index fund only last year. The fund manages a mere $76m.

For some sceptics of SRI, it makes more sense to try to change a company from within than to ostracise it. Robert Monks, an American promoter of shareholder rights, thinks that changes for the better at Shell, a British oil giant, have been won through shareholder and customer pressure. In the mid-1990s Shell was in the dock for trying to dump Brent Spar, an oil rig, into the North Sea, and for its operations in Nigeria, where it was blamed for not stopping the execution of an author and activist, Ken Saro-Wiwa. His death has not been forgotten by the people of the Ogoni, but Shell has been partly rehabilitated by shareholder activists.

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Ethical indices

"Best" behaviour

Jul 12th 2001
From The Economist print edition

New responsible share indices are irresponsible casuistry

AS SINNERS, saints and casuists know, the rewards of virtue are far from clear. Some insight may come from a new set of ethical indices that was launched on July 10th by FTSE, jointly owned by the *Financial Times* and the London Stock Exchange, to begin trading at the end of the month. Licence fees will be donated to the United Nations' children's fund.

Reuters

Compromised and dirty

More than 1,600 listed companies have been assessed for their compliance with certain measures of environmental, social and humanitarian behaviour, defined through consultation with firms, non-governmental organisations and "experts" in the growing field of socially responsible investment (SRI). The 50 firms with the highest market capitalisation that pass muster have been selected for the FTSE4Good indices for British and European shares, with a further 100 companies appearing on each of the American and world equity indices.

The omissions from the British top 50 are revealing. Inevitably, companies in the tainted businesses of cigarettes, nuclear power and arms manufacturing are excluded from the start. But perfectly respectable firms have also failed to make the grade. Tesco, a supermarket chain, faltered on its reporting of land and energy use. Royal Bank of Scotland, which does business in countries such as Indonesia that have poor human-rights records, failed, in the eyes of the examiners, to commit to sufficiently clear labour policies. Evidently, those examiners want to discourage investment in most poor countries.

While some deplore the inclusion of firms involved with genetically modified foods, others worry that a chance to bring "sinners" into the fold with a view to redeeming them may be lost by the exclusion of entire industries. Good behaviour is in the eye of the beholder. "We live in a compromised and dirty world," says Craig Mackenzie, of Friends, Ivory and Sime. The advisory committee is working on new measures to include "pariah" industries in the indices, and raising its existing standards on human rights, as more companies develop reporting systems.

All SRI indices have flaws, points out Stuart Hart at the University of North Carolina. The Dow Jones Sustainability Index, for example, uses a sophisticated questionnaire sent out to companies, and so relies heavily on firms' own assessment. Only a quarter of companies actually respond.

On the other hand, FTSE4Good comes under fire for using less stringent criteria on policy and performance in an attempt to broaden its constituents. Deborah Doane, at the New Economics Foundation in London, questions why FTSE4Good does not, for example, judge pharmaceutical firms on their human-rights policies—as it does mining and software companies, for instance—given the fuss over poor countries' right to costly medicines. It is all fertile ground for casuistry.

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Economics focus

In the balance

Jul 12th 2001
From The Economist print edition

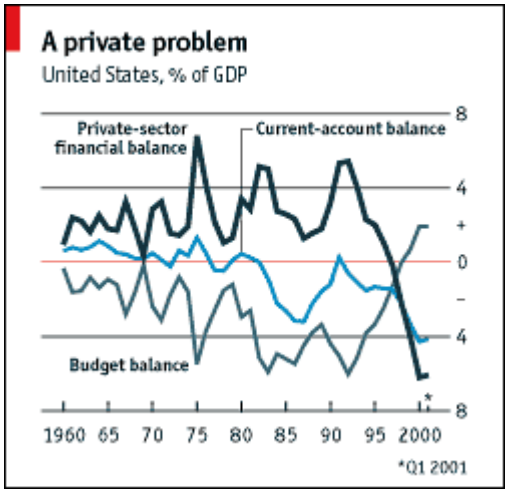
America's slowdown has done little to remove the country's serious economic imbalances

MANY economists believe that America's economy has escaped recession and may rebound in the second half of this year. But a new paper* by Wynne Godley and Alex Izurieta at the Jerome Levy Economics Institute argues to the contrary that large, unsustainable imbalances may make a recession inevitable.

Mr Godley was among the first to argue that America's boom of the late 1990s was unsustainable, for two reasons. First, private-sector spending was growing faster than income, causing a huge increase in corporate and household debt. Second, America's current-account deficit had widened to a record 4.3% of GDP. The current-account deficit has been much discussed by other economists, but few Americans pay any attention to the private-sector financial deficit.

The chart shows the financial balances of the three sectors of the economy over the past 40 years: the external current-account balance, the government's budget balance, and the private sector's financial balance. This last (calculated as the disposable income of firms and households, minus their spending) is also known as private-sector net saving, since it is equivalent to saving less investment. By accounting definition, private net saving and the budget balance combined must be equal to the current-account balance.

The government's shift from budget deficit to surplus has been much trumpeted. But far more dramatic has been the private sector's swing from a surplus of 5.4% of GDP in 1992 to a deficit of almost 7% late last year. Between 1960 and 1997, the private sector was always in surplus.



The unprecedented switch during the 1990s reflects the behaviour of households more than of firms. As a result of it, household debt climbed from 95% of disposable income in the early 1990s to 124% in the fourth quarter of last year.

Mr Godley argues that private-sector net saving will eventually rise sharply, as households repair their balance sheets, so driving the economy into recession. Plenty of economists disagree. A flurry of recent papers has concluded that the household saving rate, properly measured, is a lot higher than official figures suggest. If so, fears of a rebound in saving may be overdone (see article). But the problem is that these studies look at gross saving rather than net saving (ie, minus investment).

Consider some of the supposed reasons why household saving is higher than it seems. First, the saving rate as officially measured includes employers' contributions to pension schemes, but pensioners' benefits from those schemes are not counted in income. In recent years, large capital gains have allowed many firms to take a holiday, paying out pensions without making contributions. That means that household saving has been understated. Yet if the figure was increased to allow for this, it would also change firms' financial balance in the opposite direction (as the increased pension benefits of households show up as an increased cost for firms). Total private net saving would thus be unchanged.

Second, some have argued that household spending on cars and other consumer durables should be treated as investment, not consumption, which would lift gross household saving. Yet since this would

boost both saving and investment, private net saving would again be unaffected.

Third, it is argued that capital gains should be counted as saving. These do indeed boost wealth, but can be drawn on only if households either sell assets or borrow against those assets—and there are limits to both. Debts have to be serviced out of income; if everybody tried to realise their capital gains by selling shares, prices would crash.

The private-sector financial deficit is therefore a better measure of sustainability than gross saving. Indeed, this measure is favoured by the International Monetary Fund and the Bank for International Settlements. In its latest annual report the BIS points out that, in the past, when a country's private-sector net saving has fallen sharply below its long-run average, this has always been followed eventually by a sharp economic slowdown, as the private sector swung back into surplus and spending slumped. Examples are Britain and Sweden in the late 1980s, and Japan after 1990. In the first quarter of 2001, America's private-sector financial deficit shrank for the first time. Could this be the turning point?

What goes up...

The authors consider the likely future path of America's financial imbalances. Using the latest projections by the Congressional Budget Office for the budget balance and GDP growth implies that the private-sector deficit would rise to 8% of GDP by 2006, with debt continuing to explode. That is clearly unsustainable. Yet, at the other extreme, a turnaround of the financial deficit is unlikely to be as severe as it was in Britain after 1989, because high inflation then reduced Britain's scope to cut interest rates.

America is likely to follow a middle path. If the private sector's balance reverts to its historical average within three years, Messrs Godley and Izurieta reckon that this would cause a recession this year, with annual GDP growth in the five years to 2006 of only 1.1%. Even if the private-sector deficit fell by only half, to 3% of GDP, annual growth would average only 2% over the next five years.

To keep the three sectors in overall balance, higher net private saving must be matched by either a fall in America's current-account deficit or a swing in the budget from surplus to deficit. Forget about all those hopes of repaying public debt.

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* "As the Implosion Begins...? Prospects and Policies for the US Economy: A Strategic View". Jerome Levy Economics Institute, 2001.

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Particle physics

The fact of the matter

Jul 12th 2001
From The Economist print edition

The first results of an experiment designed to find out why the universe is composed of matter have just been announced

Get article background

IN PHYSICS, there is sometimes life after death. The constant wish of researchers who study the universe at the subatomic level is for bigger and more powerful machines. When this wish is granted by the funding agencies, the existing, smaller machines become redundant. That was the fate of PEP, the positron-electron project at SLAC, the Stanford Linear Accelerator Centre, in California. It was overtaken by events, and turned off in 1990.

In May 1999, it became fully operational again, having been refitted and redubbed PEP-II. The refit turned it into a "factory" for producing particles called B-mesons. Its new mission was to answer a question so profound that only a physicist would think of asking it: why is the universe made of matter? This week, its operators reported part of the possible answer.

Fearful symmetry

The reason why the question is worth asking is that most fundamental things in the universe seem to come in symmetrical pairs. In particular, every type of particle of which matter is composed has an equal and opposite antiparticle composed of antimatter. As every schoolboy knows, if you bring a particle and an antiparticle together, they annihilate each other in a burst of energy. Less well known is that the opposite can also happen: energy can turn spontaneously into something more tangible. When it does so, each particle of matter produced is accompanied by an appropriate antiparticle.

The Big Bang in which the universe was created was followed by the condensation out of a huge amount of energy of zillions upon zillions of such matter-antimatter pairs. So the naive assumption might be that the early universe must have contained equal amounts of matter and antimatter. But that would suggest that, when things had cooled down a bit, these particles would eventually have annihilated one another leaving nothing but energy behind. Fortunately, this naive view is wrong, as a train of events that started almost half a century ago showed.

In 1956, Chien-Shiung Wu, of Columbia University, demonstrated that certain particles have an inherent sense of left and right. The result is that their images in a mirror would not, in fact, be "mirror images" in the sense that most people understand the term. Instead, those images would be backwards in what looks like a physically impossible way.

Parity violation, as this phenomenon is called, came as a shock to theorists, but they were able to compensate for it by incorporating the effects of electric charge into their models. The resulting charge-parity symmetry solved the mirror-image problem—in theory. Yet when experimentalists began to investigate it, they found that, just occasionally, there was something wrong. The wrongness, which turned up in the interactions of particles called K-mesons, implied that matter and antimatter are not truly symmetrical. That would allow more of the former than the latter to present just after the Big Bang.

A question of degrees

But not, sadly, enough more. This is where B-factories come in. Theory suggests that B-mesons, too, should show this asymmetry. Indeed, they should show it more strongly than K-mesons do.

Unfortunately, B-mesons are hard to work with. This is because they decay very fast—usually within one and a half trillionths of a second of their creation. Because they are so short-lived, they have to be generated in huge numbers, and without too much clutter in the form of other sub-atomic particles, to make any meaningful studies of them possible. Two groups of physicists therefore decided to build specially designed machines that would spew out B-mesons in quantity, unlike typical particle accelerators, which produce an unwieldy mess of particles.

The revamped SLAC accelerator is one of these machines. The other is at KEK, a particle-physics centre in Tsukuba, near Tokyo. The two projects have been engaged in a race from the beginning. SLAC beat KEK to the first production of B-mesons by a fortnight back in 1999. It now seems to have about the same edge with the publication of the first results.

These results do, indeed, show an asymmetry in the behaviour of B-mesons and anti-B-mesons. Sadly, it is in the range that theory predicts—ie, not enough to account for all the matter in the universe. But, just as with map making, this search for matter-antimatter asymmetry requires triangulation. Two other, and different, measurements must therefore be made to resolve the question properly. Each of these measurements is the equivalent of an angle in a triangle—albeit one whose angles are located by esoteric entities known as complex numbers.

But, complex or simple, the angles of a triangle still have to add up to 180°. If, when the other two values are in, they do so, the mystery will remain. If not, the theory will have cracked open. The source of the extra asymmetry, and thus the extra matter, may then be staring researchers in the face.

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The human genome

Think of a number, then double it

Jul 12th 2001
From The Economist print edition

The "book of life" may be missing half of its words

WHEN the papers containing the first attempts to sequence the human genome were published earlier this year, some people purported to be shocked. The cause of their shock was the number (or, rather, the lack of number) of genes that it took to carry the blueprint for a human being. One paper, published by the publicly funded Human Genome Consortium (prop. Francis Collins, of America's National Institutes of Health), came up with a figure of 31,000. The other, the product of Celera, a private company (prop. Craig Venter), suggested around 26,000.

EPA

Double trouble for Venter and Collins

Within the margins of error expected of such cutting-edge research, that sounded like a consensus. The reason that many people were sceptical was that it was little larger than the figures previously arrived at for nematode worms (19,000) and fruitflies (13,600). Surely, these scientists argued, people are a lot more complex than worms and flies. And that should mean that they must have many more genes.

A paper just published in *Genome Biology* suggests that the sceptics might be right, after all. Bo Yuan, of Ohio State University, in Columbus, and his colleagues, suspect that the human genome contains not 30,000 genes, but more than twice that figure. Their estimate, arrived at using a different approach from that employed by Celera and the Human Genome Consortium, is 65,000-75,000.

That sounds like a serious discrepancy, and it is. But finding genes is not yet an exact science. Only a small fraction of the human genome's 3 billion base pairs (the chemical "letters" of which DNA is composed) actually belong to genes. Even the newly published estimate implies that this fraction is just 4%. Moreover, most genes are split up into segments, known as exons, that are separated by long stretches of meaningless drivel. Although this drivel is copied during the first stage of the process by which genetic information is used to build the proteins that do the donkeywork of maintaining life, it is then cut out of the copies before they are transferred to the protein-making machinery.

The signals that indicate where the copying machinery should start and stop, which is a good working definition of where on a chromosome a gene begins and ends, are imperfectly understood. That makes searching for genes by looking at the raw code that the two sequencing projects provided a hazardous business. Additionally, despite the brouhaha at the time, what was announced in February were only drafts. Many small gaps remain, and these complicate still further the job of identifying genes by looking directly at the sequence of base pairs.

One way round this is to intercept the messenger molecules that the copying machinery puts out, and decode them. This technique has been used extensively to try to identify which genes are active in particular tissues. The result is a lot of data, but those data are scattered in numerous databases that are organised and maintained in diverse ways by various research teams.

An additional complication is that the decodings usually take the form of expressed-sequence tags (ESTs), which are merely short pieces of genetic information, rather than full transcripts of genes. Some of these tags can be matched unambiguously to the bit of the human genome they originally came from (which is why they are collected in the first place). But many cannot.

If different ESTs from the same gene can be linked together successfully to resemble something more

like the gene from which they originally derive, the result is much easier to match to the genome. That has been done haphazardly in the past, but Dr Yuan and his team have systematised the process. They have trawled around the disparate databases, fished out the ESTs, and patched them together using a computer program to match the overlaps between them. Another program then takes the so-called transcriptional units that this exercise produces, and tries to match them with their “parental” sequences in the public database assembled by the Human Genome Consortium.

The results suggest that a lot of genes have been missed by more traditional search methods. They also throw light on the way that genes are organised within chromosomes, confirming that many exist in clusters of closely related individuals.

For example, 60% of “zinc finger” genes (whose protein-products help to regulate the expression of other genes), are located on chromosome 19. It looks as though they have evolved by repeated duplication from a single “grandmother” gene, followed by specialisation to do slightly different jobs. Protein-kinase genes, whose products are involved in intracellular signalling, are similarly concentrated on chromosome 1. The researchers tripled the number of protein-kinase genes known from this chromosome. They also found hints that genes whose protein-products work together in a cell have sometimes ended up as neighbours on a chromosome. That might simplify the co-ordination of their expression.

By no means all of the transcriptional units that Dr Yuan has identified have yet been matched to the genome, so there is still some wiggle-room for those who think a total of more than 60,000 is too high. Nevertheless, he and his colleagues seem to have created a powerful tool to assist a process that, despite the hubris that frequently surrounds it, is still quite a lot like looking for needles in haystacks.

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About sponsorship

Superconducting power cables

At last!

Jul 12th 2001
From The Economist print edition

The first practical superconducting power cables are now being installed

COMPARED with cars and pop music, electricity transmission is hardly the most glamorous subject on earth. But Detroit, well known for the first two, is about to make history in the third. Engineers are now installing a set of superconducting power cables beneath its streets.

Superconductivity—the ability of a material to conduct electricity without losses due to resistance—has been known about for 90 years. For the first 75 years, though, its applications were restricted by the fact that it seemed possible only within 23 degrees of absolute zero (23K). In 1986, however, a ceramic material that superconducted at 36K was discovered. That led to a rush to find similar materials that would superconduct at even higher temperatures. Now, several are known that do so above 77K, the boiling-point of nitrogen. That means they can be cooled with liquid nitrogen—and liquid nitrogen is cheap.

Even so, the longed-for boom in applications did not happen. Because high-temperature superconductors, as these materials are known, are ceramics, they are brittle and difficult to draw into wires. That has limited their use. But American Superconductor, a firm based in Westborough, Massachusetts, has persevered. By grinding the material up, packing it into silver tubes, rolling the tubes into tapes, heating the tapes up, and then rolling and heating again and again, its engineers have produced wires long enough to be useful as superconducting cables.

The main reason for wanting to install superconducting power lines in cities is not, perhaps surprisingly, to reduce transmission losses. These amount to only about 7% of the energy originally generated, a figure that is offset by the need to keep the cables cold. The real advantage is that the lack of resistance means that a given thickness of superconducting cable can carry between two and ten times as much power as the same thickness of copper. This could provide a relatively cheap way to meet rising demand for power in cities. Instead of digging up streets to install new, high-capacity conduits, existing conduits can be “retrofitted” with superconducting cables.

In the Detroit project, for example, three superconducting cables replace nine copper ones. Detroit Edison, a local power company, is laying 400 metres of these cables. They will carry enough current to supply 30,000 residential customers. A similar, though smaller, pilot project has recently been switched on in Copenhagen. In this case, 90 metres of superconducting cable have been installed at an electricity substation owned by Copenhagen Energy.

If successful, these and other small-scale demonstrations could lead to the widespread commercial take-up of superconducting cables within the next few years. A study published recently in *Physics World* predicted that within ten years of the first commercial sale such cables will make up over 50% of the underground transmission market.

However, Paul Grant, a superconductivity expert at the Electric Power Research Institute in Palo Alto, California, remains cautious. He points out that nobody in the superconductivity business is making money yet. Indeed, American Superconductor lost about $20m last year, and will probably not make a profit for at least another two years.

Superconducting-wire technology has, though, made enormous progress. Manufacturers have increased the lengths of the wires they can produce many times over during the past few years, and have reduced the price considerably. Superconducting cable used to cost around $1,500 per kiloamp per metre, the standard industry measure of conducting capacity. Now, American Superconductor sells wire for $200 per kiloamp per metre, and expects to reduce the cost to about $50 per kiloamp per metre when it opens a

new production plant next year. Reaching $25 per kiloamp per metre, the cost of copper cable, will take a little longer. The problem is no longer the cost of the ceramic itself, but of the metal casing. This is one cloud that is caused by its silver lining.

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Mine pollution

Two wrongs can make a right

Jul 12th 2001
From The Economist print edition

Waste products from two different industries could cancel each other out

WHEN it comes to despoiling the planet and polluting the environment, the mining industry is a world beater. Besides the unsightly effects that many mines have on the landscape, they usually churn out vast quantities of toxic waste in the form of acidic drainage-water and tailings—the fine particles of rock produced when ore is ground down to release the minerals it contains. These tailings are not just a harmless inconvenience; they often contain poisonous heavy metals such as arsenic, cadmium and lead. And tailings are produced in large quantities: on average, 991 tonnes-worth for every 1,000 tonnes of ore that is mined.

The most common way of disposing of mine waste is to dump it behind a dam. Around the world, there are tens of thousands of such dams, containing billions of tonnes of waste. Unfortunately, dams can fail. In April 1998, the collapse of a dam at the Aznalcóllar mining bed in southern Spain polluted the Guadiamar river and the Doñana wetland, an important wildlife reserve. The failure in January 2000 of the Baia Mare dam in Romania contaminated the drinking water of 2.5m people.

A cheap solution may now be at hand as a result of work by David McConchie of Southern Cross University, in East Lismore, Australia. Dr McConchie's raw materials are "red mud" (the waste left over after the refinement of bauxite, the principal ore of aluminium) and sea water. The result, marketed under the name of Bauxsol by Virotec International, a former gold-mining company, has proved to be an effective mopper-upper of mining waste.

Red mud is caustic, but the seawater reduces its alkalinity to a level that can be handled safely. Bauxsol is still alkaline enough, however, to neutralise the acidity of the drainage water in tailings ponds. Heavy metals in the ponds are then mopped up by clay minerals in the mixture. The metal atoms stick to these minerals and drop out of the solution to form an inert sediment.

Bauxsol has been tested at the Mount Carrington mine in Australia, and is now undergoing more extensive tests at the Gilt Edge mine in Colorado. Water cleaned with it meets Australia's stringent requirements for the protection of aquatic ecosystems, and can thus be released into rivers for reuse. Indeed, 1m litres a day is being released from the Mount Carrington tailings dam into the local Clarence River basin. To prove he thinks that it really is clean, Dr McConchie even drank a glass of it.

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About sponsorship

Vichy France

Breaking with the past

Jul 12th 2001
From The Economist print edition

To mark Bastille Day, we review new books on France, past and present, starting with the dark years of Vichy

FOR 30 years after the second world war, few French historians were prepared seriously to poke around in the conventional mythology that had developed about the four years of German occupation. Military defeat in 1940, went the myth, was followed by occupation imposed on the French people by Marshall Pétain, which was lifted only when the Free French—led by General de Gaulle—joined with the Resistance to deliver France from the Nazis. But, spurred by foreign scholars who broke the spell, a growing number have turned to this period with single-minded intensity, and in France today hardly a week passes without a new book on the subject.

France: The Dark Years, 1940-1944
By Julian Jackson

Oxford University Press; 660 pages; $35 and £25

Buy it at
Amazon.com
Amazon.co.uk

Julian Jackson draws heavily on this vast research. He uses mainly secondary sources but has managed to tease the complexities of the occupation into a story that is both ingenious and convincing. He roots Vichy in French history, beginning in 1871 with the end of the Franco-Prussian war, and shows the extent to which many of the ideas that became so influential in 1940—such as the need for a "moral order" based on hard work, the family, the land and the peasantry—had been widely discussed during the previous two decades. He also takes the Resistance more seriously than many Anglo-Saxon historians. He is at pains to examine its organisations and ideas in detail and to show that men and women fought for many different visions of France, some of which bore a disconcerting resemblance to Vichy's own.

Mr Jackson stresses, in particular, the complexity of Vichy France. He shows that there were anti-Semites in the Resistance and anti-Nazis at Vichy. He describes how the Resistance had to be built from scratch by people who did not know how long the occupation might last, nor how best it might be ended, nor even what people in other parts of France might be doing. He points out that on the rare and dangerous occasions when they met, Resistance leaders told each other outrageous lies about the support that they enjoyed. Nor did any of them really know, at least in the early days, what role the eccentric and right-wing De Gaulle, whose famous broadcast from London on June 18th 1940 was heard by almost nobody, might play.

Perhaps Mr Jackson's sensitivity to these nuances is sharpened by a certain tension in his own attitude. This book consciously eschews the shock tactics so often adopted by Anglo-Saxon historians who write about Vichy, many of whom assume that the French continue to be "frightened of their Vichy past" and refuse to confront it. Mr Jackson's work is careful and sober; it is also, in some ways, rather moral. He believes that collaboration and resistance are useful categories, that French people made choices in 1940 and that some choices were better than others.

He is particularly good at evoking the dangerous glamour of that small group who dominated artistic and intellectual life in occupied Paris. This was the world in which a young diplomat, Roger Peyrefitte, briefly gave up chasing adolescent boys to dine on caviar with the head of the Paris Gestapo and Louis-Ferdinand Céline, a novelist, was escorted out of a dinner at the German embassy after launching a tirade in which he insisted that Adolf Hitler was dead and had been replaced by a Jewish impersonator.

Some of the best passages come from the empathetic treatment of those, such as Pierre Drieu la Rochelle or Robert Brasillach, who wished for German victory; or others, including Jean Cocteau and Sacha Guitry, who simply refused to let a world war get in the way of a good party. One suspects that,

like Patrick Modiano, who wrote the script for Louis Malle's "Lacombe Lucien" (1974), one of the earliest mainstream films to highlight the ambiguities of collaboration and resistance, Mr Jackson is fascinated by the very people whose politics he most abhors.

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Contemporary French art at auctions

Selling well

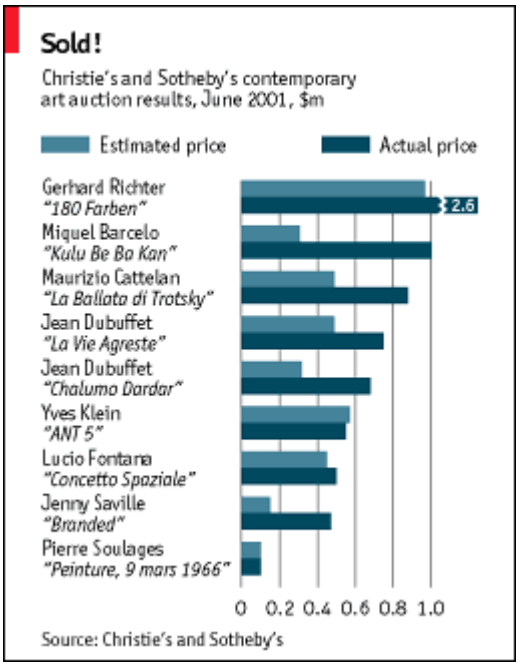
Jul 12th 2001
From The Economist print edition

ARTS WATCH

Contemporary French art is holding its own

THE French foreign ministry announced recently that auction prices for works by contemporary French artists have fallen lamentably far behind those of artists from other European countries. Seen in perspective, though, the situation is less drastic than it might appear at first blush. True, no contemporary French artist is in the same category as, say, Gerhard Richter, who stood in pole position at the June contemporary art sales at Sotheby's and Christie's in London. But then nor are many other artists. Mr Richter has been one of the most consistently successful artists at auction in recent years. The astronomical prices his works have been selling for rank him alongside such bankable stars as Andy Warhol and Jeff Koons.

Mr Richter's exceptional results aside, three French artists, Jean Dubuffet, Yves Klein and Pierre Soulages, did notably well at the London sales, holding their own against other continental and British artists. (It should be noted that in the context of art auctions "contemporary" does not necessarily mean living; both Dubuffet and Klein are dead.) In particular, two works by Dubuffet went under the hammer well above their estimates, as did Jean-Marc Bustamante's "Lumière IX" (not listed), which fetched $28,365—not an extraordinary price by current standards, but still roughly $10,000 over its estimate.



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About sponsorship

France and the world

Speaking up for the nation

Jul 12th 2001
From The Economist print edition

THE late Enoch Powell, a learned and provocative English Tory, liked to say that British foreign policy now consisted in finding out what the United States was going to want of Britain, and doing it in advance. It has often seemed as if the opposite were true of France. Charles de Gaulle, France's leader from 1958-69, took pride in exasperating American presidents, starting with Franklin Roosevelt. French politicians since have continued the local tradition of twitching Uncle Sam's beard.

France in an Age of Globalization
By Hubert VÃ©drine and Hubert Védrine

Brookings Institution Press; 144 pages; $16.95 and £12.50

Buy it at
Amazon.com
Amazon.co.uk

The favour is returned. When in June last year Hubert Védrine, the French foreign minister, declined to join more than 100 other nations in an American-inspired declaration of support for democracy, the *New York Times* headlined its report, "At democracy's picnic, Paris supplies ants". Mr Védrine had already gained a certain notoriety in the United States by describing it in 1998 as the world's only "hyperpower", a term which sounds more pejorative in English than in French and which offended some Americans.

How serious is any of this? France-bashing in America and America-bashing in France are so routine as to be treatable for most purposes as background noise. For all the theatrics, both countries, when it counts, behave to each other as allies.

Nevertheless, France, like Britain, is having to reassess its national interests and its national identity, not only vis-à-vis America but with regard to Germany and Europe. Mr Védrine cannot resist a tease or a sharp quote-line (he was President Mitterrand's spokesman), and he has no real answers. Still, his questions are good.

He identifies where he thinks America and France are currently close (the Balkans, the Middle East) and he pays tribute to Madeleine Albright, America's previous secretary of state. But he notes where they differ (missile defence, for example), and he asks how countries like France can maintain a strong culture and a sense of themselves amid globalisation. He talks elegantly though inconclusively on how France's foreign policy can be at once French and European, and he expresses the doubts of an old-fashioned realist about international criminal courts and humanitarian intervention.

In sum, Mr Védrine on paper is less provocative than by repute. His short book is the transcript of an extended talk with Dominique Moïsi, a journalist and deputy director at France's Institute for International Relations. Published in France last year, it is now translated with new material.

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Anglomania

Frogs and rosbifs

Jul 12th 2001
From The Economist print edition

Two nations with a common language

THE mutual fascination of the British and the French—or, more accurately, the English and the French—is hardly a surprise. To mock the "frogs" as posturing, self-interested intellectuals is a staple of the English press, and not just the tabloids. Their French counterparts find it easy to caricature *les rosbifs* as pink-faced philistines. As both these books point out, the love-hate relationship of England and France has a long, and continuing, history. Indeed, the bookshelves are packed with attempts, scholarly and otherwise, to explain it.

Honni soit qui mal y pense
By Henriette Walter

Robert Laffont; 364 pages; FFr139

Buy it at Amazon.fr

La MÃ©sentente Cordiale
By Christine Geoffroy

Grasset/Le Monde; 400 pages; FFr149

Buy it at Amazon.fr

What makes these two particular efforts so fascinating is that the authors analyse the relationship not through the historian's prism of war, empire, economics and so on, but through language. Hence Henriette Walter's clever title (the British royal family uses French to express the motto, "Evil be to him who evil thinks" but misses out one of the "n"s), and the benign subtitle noting "the unbelievable love-story between French and English".

Indeed. Ms Walter, sketching out an Indo-European linguistic tree whose European branches were both Latin and Germanic, shows how French and English have influenced each other for centuries—despite the protectionist efforts of language purists (notably the Académie Française). The result is that French and English have a greater overlap of shared vocabulary than French and Italian (or, for that matter, English and Italian).

But the two languages also have a number of *faux amis*, friends so false that they will provoke many an embarrassing misunderstanding. Do not compliment a Frenchman for being "candid", when for him *candide* means "naive", and certainly do not say he is versatile, which he will take to mean either volatile or fickle.

The beauty of Ms Walter's book is that it is so accessible. She is both scholarly and amusing. For example, virtually every article has a quiz to tease the interest while proving her point. Surely Millevaches, a plateau in the Massif Central, is a place where a thousand cows might graze: maybe, but the name is derived from the Celtic "mello" and probably the Latin "vacius"—and so actually means "empty hill-top".

Christine Geoffroy's book is equally accessible, but not (at least to this Anglo-Saxon reviewer) as much fun. Her "Friendly Disagreement" is subtitled, "a voyage to the heart of the intercultural Franco-English space", a phrase that sounds perfectly reasonable in French but comic and preposterous in English.

What she means, however, is perfectly sensible (another word which means something quite different in French). A global economy implies multinational companies and a global job-market, which means French employees for English companies and English employees for French ones. But will analysing the reflections of these employees do much to clarify mutual misunderstanding? Ms Geoffroy does a better job with her voyage through history, though when she comes to the present she is less convincing. Her interviewees are individuals, whose experiences may or may not be generally applicable; certainly, the English have a sense of irony that the French often find baffling, but are English bosses really as hierarchical and unapproachable as a certain interviewee, François, maintains? A better observer was the man who said that an Englishman may be hard to convince, but once convinced, will do what he's told; by contrast the Frenchman will agree—but drag his feet for another two years.

Happily, neither author is trapped in the linguistic chauvinism that the English all too often attribute to

the French. Indeed, Ms Walter approvingly quotes the observation of H.L. Mencken (admittedly an American) that “a living language is like a man suffering incessantly from small haemorrhages, and what it needs above all is constant transactions of new blood from other tongues.”

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About sponsorship

Bestselling diaries

The other kind of journalism

Jul 12th 2001
From The Economist print edition

French readers are devouring diaries

THE appeal of journals is easy to understand: a good one promises anecdote, confession, soul-searching and the odd revelation or whiff of scandal. Even the plain recording of everyday facts allows the reader to enter directly into the writer's mind and the world in which he lives, and this, of course, can contain big surprises.

Paul Morand made his name in the 1920s and 1930s as the author of two finely stylised novellas and several books about his career as a diplomat. His "Journal Inutile" (Pointless diary), which covers the years 1968 until his death in 1976, has just been published, 26 years later. The book has caused a stir in France. As when the correspondence of Louis-Ferdinand Céline, another notoriously anti-Semitic writer, appeared, the critical establishment has tended to judge the author's life and work as a unified whole.

The journal reveals Morand as an insufferable snob straight out of a Proustian salon, whose attitudes are stuck in the Third Republic. He was always rumoured to have been particularly close to the Vichy government, and, for many, his retreat to Switzerland after the war spoke for itself. Still, few had expected such conceit, racism, homophobia, misogyny and paranoid anti-Semitism as are displayed in the journal—not to mention his bigoted hatred of De Gaulle. Thirty years after the war he is still huffing: "I ignored the call of June 18th, seeing De Gaulle arriving with herds of Jews and communists."

Journal Inutile
By Paul Morand

Gallimard. Volume I, 1968-1972; 856 pages; FFr195. Volume II, 1973-1976; 798 pages; FFr195

Buy it at Amazon.fr

Se perdre
By Annie Ernaux

Gallimard; 294 pages; FFr110

Buy it at Amazon.fr

Les Plats de Saison
By Jean-FranÃ§ois Revel and Jean-François Revel

Seuil; 440 pages; FFr135

Buy it at Amazon.fr

Morand's racism and snobbery are offset (though not excused) by his swift intelligence, wit, curiosity, and his sharp one-liners. There is plenty of gossip about the Académie Française. Morand rails against its pomp and vanity—yet never misses a session. This was the least of his contradictions. He adored his wife but constantly betrayed her. He hated the pace of modern living but was driven by a restless urge to seize the day. And, despite his prejudices, Morand remained faithful to his friend and mentor, Marcel Proust, a Jewish homosexual. Though the journal weighs in at a hefty 1,700 pages, it contains almost nothing in the way of serious self-examination. Morand expresses no regret over his Vichy past and doesn't give a thought to his illegitimate children. He expresses sadness and humility only after his wife's death when his own end is approaching.

Annie Ernaux is utterly unconcerned with society gossip and wholly wrapped up in the drama of her own love life. In "Se perdre" (Losing oneself), she relates the details of her year-long affair with a married Russian diplomat in Paris in the late 1980s. Her lover's charms are not entirely obvious: he adores big cars, western labels and Stalin, and, in her, most admires the established writer who goes for lunch with François Mitterrand.

Ms Ernaux, best known as the author of "La Place" (The square), evokes the familiar rituals of passion, the sweet torments of waiting and what she describes as the violence of loss. She has already told this story in her autobiographical novella "Passion simple" (Perfect passion), but by switching genres and perspective she aims to highlight something "darker and cruder". Where the novella gave a sense of tidy resolution and even elation, the journal throws us into the complexity of the present and the uncertainty of the future.

"I make love and write as if I were to die after," she says. Lines like this smack of teenage angst, yet Ms Ernaux's matter-of-fact account manages to avoid the pitfalls of exhibitionism, while forcefully

demonstrating how self-awareness can be achieved through alienation.

The appetite of French readers for journals has led Seuil, a Paris publisher, to invite a different personality each year to keep a journal with a view to publication. For 2000, Seuil asked Jean-François Revel, a right-wing philosopher and newspaper columnist. Fortunately, there is nothing “millennial” about his book, “Les Plats de Saison” (Seasonal dishes), except for its vituperations against the vulgarity of the *fin de siècle* celebrations. Mr Revel, now in his late 70s, is full of righteous indignation. Day by day he denounces the corruption of the French state, the apathy of civil servants, the condition of public services, José Bové’s populist anti-Americanism and France’s nationalism.

Despite his independence of mind, however, he is far from neutral. His defence of Ronald Reagan is confused and weakened by over-statement. Though witty in parts, this journal reads like a collection of editorials which lack both the freshness of journalism and the weight of fully considered judgments. Like many diaries that are written to order or published too quickly, it manages to sound both timorous and contrived. By contrast, the appearance in September of the last diary of a great Franco-American writer, Julien Green, who died in 1998, should prove well worth the wait.

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18th-century French history

L'Autrichienne

Jul 12th 2001
From The Economist print edition

Marie Antoinette
By Antonia Fraser

Weidenfeld & Nicolson; 488 pages; £25. Doubleday (October); $35

Buy it at
Amazon.com
Amazon.co.uk

LOOKING at David's extraordinary drawing of a haggard, crop-haired woman riding in a cart to the guillotine in 1793, it is hard to believe she had been the queen of France, the daughter of the late Emperor of Austria, or indeed that she was only 37 years old.

Nobody would argue that the trial was strictly fair—she was convicted of conspiring to cause civil war—or that she deserved execution. It was not by choice that the 14-year-old archduchess was sent away from Vienna to marry Louis XV's stodgy grandson. It was not her fault that Louis XVI—he succeeded to the throne in 1774—was too ill-informed or apathetic to consummate the marriage for seven years. The foreign consort, naturally, bore the blame: "If I were only a mother, I should be considered a Frenchwoman," the queen wrote. By the time she produced a son, in 1785, she was beyond rescue, hated at court and despised outside it for being manipulative, frivolous and for shamelessly enriching the families of her female lovers.

The real villains, according to Antonia Fraser in this well-researched and emotively narrated life, were the journalists and cartoonists who pilloried the queen, creating a monster from one whose chief crime was to be careless about her public image. Dead queens are close to Ms Fraser's heart; she wrote with similar warmth about Mary Queen of Scots. A case of sympathetic identification? One Catholic Antonia who has not always been kindly judged by the press, making a case for the defence of another? It's a tempting thought. Marie Antoinette was christened Maria Antonia, after all.

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About sponsorship

19th-century French history

Fun and games

Jul 12th 2001
From The Economist print edition

Paris Between Empires: 1814-1852
By Philip Mansel

John Murry; 575 pages; £25

Buy it at Amazon.co.uk

ON FEBRUARY 13th 1820 the Duc de Berri, last of the royal Bourbon line, was fatally stabbed by a Bonapartist outside the Paris opera house. His wife had just become pregnant, and the idea that the monarchy could be saved by "the miracle child" quickly began to take shape. At the birth, witnesses were present to attest that this was the true blood royal and the mother had the presence of mind to insist that a veteran Bonapartist, Marshal Suchet, should tug the umbilical cord: "Mais tirez donc, Monsieur le Maréchal!" The government, overjoyed, announced that it would distribute 37,000 meat pies to the poor—so prudent pet owners locked up their cats. If stories like this raise your eyebrows or make you smile, this is a book for you: it is as richly stuffed as a *boudin truffé*.

You might think that writing about Paris between empires—between the fall of Napoleon I and the rise of his nephew, Napoleon III—is a slightly odd enterprise. The former made Paris the centre of European power; the latter, by transforming the city into a showpiece of modernity, turned it in the eyes of many into "the capital of the 19th century". But Philip Mansel demonstrates that Paris in decline had its peculiar attractions. As in Weimar Berlin, or Moscow and St Petersburg in the 1990s, or indeed like Paris itself in the 1950s, the collapse of power drew a picturesque crowd seeking social, artistic and financial opportunities.

From the Duke of Wellington down, the victors and their hangers-on came to spend their money on high and low adventures. Paris was cheap, so people who did not greatly count in London could make a splash. Successive French kings were anglophiles—perhaps genuinely and certainly politically—so British tourists could be courtiers for a day. The richer and more ambitious could buy splendid mansions from Napoleon's impoverished marshals and have the Comtesse Juste de Noailles draw up the guest lists for their parties.

The French, released from wartime constraints and the authoritarian discipline of the Little Corporal, simultaneously discovered the outside world, and not least the heady stimuli of Shakespeare, Byron and Sir Walter Scott.

The author's fascination with celebrities sometimes suggests a 19th-century *Hello!* magazine, albeit one dominated by duchesses, not pop-stars. He shows that the former led far more interesting and no less licentious lives than the latter, and had infinitely more power and influence in politics and culture. This book gives us the inside story with a lavish helping of gossip. In other hands this might prove cloying, but fortunately Mr Mansel writes well and arranges his material with skill and lightness of touch. After several pages of duchesses and their salons a casual reader might flag. But the *longueurs* are rare, for as well as being a fertile anecdotalist, the author recounts the dramatic events with force and economy.

Mr Mansel has not really written a history: there is more description than analysis. The later years are treated perfunctorily, and a chapter called "The People" seems to have been included out of a sense of obligation. Nor is the book about the whole city of Paris. Nearly all its action takes place in the space of a brisk walk from the mansions of the "noble" Faubourg Saint-Germain, past the Palais Bourbon, across the Seine to the vast Tuileries palace, past the brothels and restaurants of the Palais Royal and up the rue Richelieu to the boulevard, where society promenaded with a relaxed nonchalance that visitors contrasted with the grim haste of London.

Where Paris most differed from other European cities was in its concentration of activity: political, economic, cultural and social. Whereas in Britain, Italy and Germany, these activities were somewhat dispersed among rival cities, universities, courts and country houses, in France every stream ran into the Seine. Mr Mansel is an authority on this Indian summer of French royal and imperial court society, and

shows to the full here his knowledge of its people, places, books and archives. What a gossip columnist he would have made. And what a prefect of police.

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Intellectual adventurers

Inventing himself

Jul 12th 2001
From The Economist print edition

André Malraux: Une Vie.
By Olivier Todd.
Gallimard; 698 pages; FFr175

HALF Chateaubriand, half Tintin, André Malraux was associated with almost every important moment of the 20th century. He was brought up above a sweet shop and left school at 17. But when, in his mid 20s, he was arrested for stealing monuments from a Cambodian temple, he was already sufficiently well regarded as a writer for *le tout Paris* to leap to his defence. Malraux later established a squadron in the republican airforce during the Spanish civil war and, in spite of his rather late entry into the Resistance, commanded a celebrated regiment in the Free French army. By the time he was 45 he had won both the Prix Goncourt, France's most prestigious literary award, and the Distinguished Service Order, one of the British army's highest awards for gallantry.

AP

They took his cigarette away

Malraux's novels, "La Condition Humaine" (Man's Fate), 1933, and "L'Espoir" (Man's Hope), 1937, among others, were often autobiographical, but his life was constructed to look like a novel. He was always preening himself in the mirror of history, always wondering how his life would look to the biographer. Claims he made about his experiences were often pure fiction—he boasted of non-existent war wounds and, revealingly, defined fame as "cutting a scar on the map".

The most interesting period of Malraux's life coincided with an uncharacteristically reclusive time after France's defeat in 1940. He withdrew to a house in the south to write art history, dismissed anti-German activists with lectures about realism (not a quality that loomed large during any other period of his life) and maintained friendly relations with a ferocious collaborationist, Pierre Drieu la Rochelle. Even at this stage, however, Malraux had a strong sense that he was a figure of world importance. When *Life* magazine refused to serialise one of his novels, he responded, with rueful surprise: "I am less well known than Hitler."

The war was an important turning point. Malraux moved away from communism, to which he had almost given allegiance in the 1930s, and subsequently played an important part in preventing the French Communist Party from using the Resistance as a political vehicle in post-war France. He also acquired a new allegiance, this time a lasting one, to Gaullism.

Malraux's apotheosis came with General de Gaulle's return to power in 1958. He dreamed of a ministry with real power. And it is interesting to speculate on what might have happened to his reputation if he had been given the interior ministry that he so coveted, and thus been responsible for the French police during the Algerian war or the events of 1968. As it turned out, he was given the culture ministry, which was ideal for him. The writer/statesman had privileged relations with the statesman/writer. He was often photographed in thinking pose, wreathed in smoke. And though his cigarette was airbrushed out of a recent issue of French stamps, for a while, Malraux provided his homeland with a kind of artistic *force de frappe*—the *rayonnement* of cultural distinction compensating for the absence of any real military or economic power.

Albert Camus famously remarked: "I love justice but I also love my mother." Malraux, by contrast, loved abstract causes more than he loved any individual—he seems to have given little thought to the

problems that his estranged Jewish wife and their daughter faced during the occupation. Olivier Todd is particularly sensitive to the tensions within Malraux's family and also, perhaps, to the ways in which these revealed wider differences between generations. Mr Todd himself had an awkward childhood, growing up in wartime Paris with an absent father and an English mother. He belongs to an in-between generation. He does not share the ideological certainties of his mother, a communist who idolised Malraux during the 1930s. Nor does he share the post-ideological certainties of his son, a demographer who published a prescient book on the coming fall of the Soviet Union in 1976, the year of Malraux's death.

How successful is Mr Todd as an emissary from one generation to another? He is brilliant at explaining why we should be interested in Malraux, but, when it comes to why we should like or admire him, one feels that Mr Todd is caught between the piety of his youth and the knowledge that has come with age. He struggles to show Malraux in the best possible light but presents evidence that will encourage others to draw less charitable conclusions.

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About sponsorship

George Dawson

Jul 12th 2001
From The Economist print edition

George Dawson, who discovered literacy late in life, died on July 5th, aged 103

AP

FOR the first 98 years of his life George Dawson could not read or write. He was persuaded that it was never too late to learn and turned out to be a remarkably able student. In his remaining five years he became a celebrity in the United States. Television programmes were made about his life. He was awarded honorary degrees by two universities. A school was named after him.

Literacy, or rather the lack of it, can be a touchy subject in countries whose people are materially rich but may have difficulty in constructing a decent sentence. According to the World Bank, 99% of Americans can read and write. But a report by the OECD in April shattered any complacency about this figure for the world's richest country by claiming that 60% of Americans aged 16 to 25 were "functionally illiterate", meaning that when it came to, say, filling in a form they were stumped. A test of simple numeracy was included by the OECD, which involved the reading of a timetable, unfairly say some, realistically say others. The United States came top of the OECD's list of shame. Finland and Denmark did best of the industrialised countries, each having only 10% of illiterate young dunces.

So here was the improbably-aged Mr Dawson. If he could at least learn to stop signing his name with an X, surely those young slackers could make more of an effort to cope with the hard stuff. Such was the theme of Mr Dawson's philosophising in his appearances at schools, universities and, most importantly, on television.

"I am still learning," he would say, in his rolling southern accent. He was born in Texas, whose rapid development as an agricultural state in the early 19th century had been based on slavery. George Dawson was the grandson of a slave. So, as well as becoming a teacher's pet, Mr Dawson was taken under the wing of black reformists. He obliged them with tales of a harsh life. When he was ten, he said, a friend of his was lynched. You could not trust the white man, he said.

How long a life?

Along with educationalists and reformists, George Dawson was adopted by what might be called the long-lifeists, an important group in the United States. To get to a great age is an accomplishment; to do so and remain clear minded is a bit of a marvel. The long-lifers' heroes are the likes of John Glenn, who circled the earth at the age of 77, and Goya, who was still painting rather well at 80. One group names a "centenarian of the month", who is closely questioned about how he or she made it.

Mr Dawson, its choice for October 2000, catalogued a life of continuous manual labour, starting at the age of four as a farm hand. It had some variety. He had worked in the gangs that had laid railways in Texas; he once travelled to Canada to see what snow was like. He had tamed wild horses. He once played baseball professionally. He had outlived his four wives, his four siblings and two of his seven children. But his experiences did not offer a clue to a reliable elixir anxiously sought by long-lifeists. Even his diet was ordinary: a beef sandwich for lunch, fish for supper. He seemed to have reached a great age more by luck than scheming.

The sight of Mr Dawson on television, looking fit and wise, aroused mixed feelings among Americans. For the rich, long life has come to be regarded as the new human right. The United Nations itself lists

longevity as one of the criteria for determining quality of life. But what of those people who have outlasted their quota of threescore years and ten only to be kept in a state of half-life by the skills of medicine? Such questions have dimmed much of the sentimentality attached to America's extraordinary number of centenarians—some 70,000 and rising. A writer in the March issue of *Psychological Science* observed, "Our society is living longer, and the issue is, if you live longer, what are those last years like, and is length itself a good thing?"

At the age of 102 Mr Dawson the scholar gained fresh attention by relaunching himself as an author. He published a book of memoirs, albeit written in collaboration with a schoolteacher. Some people were surprised by the book's Panglossian title, "Life Is So Good", when previously Mr Dawson had given the impression that much of his life had been pretty awful. Like many biographies some bits ring truer than others. This is one of the truer-sounding bits:

> I kept it a secret that I couldn't read...When I travelled somewhere I could never read a sign. I had to ask people things and had to remember. I could never let my mind forget anything. I listened to the news and had to trust what I heard. I never read it for myself. My wife read the mail and paid our bills... People wonder why I didn't go to school earlier. But when I was young I had missed my turn to go. One day, out of the blue, a man came to the door. He handed me a piece of paper which I couldn't read. He said there were some classes for adults. My turn had come. I always thought I could drive a spike as good as any man and cook as good as any woman. I just figured if everybody else can learn to read, I could too.

A quite complex man had discovered happiness in an unconsidered pleasure. For nearly 100 years, George Dawson said, his name was X. "Writing my real name was one of the greatest things in my life."

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Money and interest rates

Jul 12th 2001
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Jul 11th 2001)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+13.1	+ 6.9	May	5.04	6.16	5.37	6.08	6.13	7.63
Britain	+ 6.7	+ 7.4	May	5.19	6.06	5.21	5.08	5.14	6.43
Canada	+12.7	+ 6.2	May	4.24	5.61	4.89	5.89	5.86	7.33
Denmark	+ 1.5	– 3.5	Apr	5.03	5.72	4.74	5.27	5.69	7.17
Japan	+ 8.1	+ 3.2	Jun	0.01	0.12	0.04	1.28	1.75	1.30
Sweden	+ 5.9	– 1.4	May	4.35	4.04	4.86	5.37	5.22	5.73
Switzerland	– 1.2	+ 2.2	May	3.23	3.41	3.39	3.36	3.80	4.12
United States	+ 1.0	+10.9	May	3.62	6.53	4.05	5.29	6.49	7.06
Euro area†	+ 3.5	+ 5.4	May	4.46	4.72	4.28	4.97	5.20	5.66

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 5.69%, Japan No.232 1.30%. Central bank rates: US fed funds 3.75%, ECB refinancing 4.50%, BOJ overnight call 0.01%, BOE repo 5.25%.
Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, OM Fixed Income Exchange, Warburg Dillon Read, DRI-WEFA, Westpac, Thomson Financial Datastream. Rates cannot be construed as banks' offers.

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Commodity price index

Jul 12th 2001
From The Economist print edition

1995=100

	Jul 3rd	Jul 10th*	% change on one month	% change on one year
Dollar index				
All items	68.6	69.0	– 1.0	– 4.0
Food	67.9	68.8	+ 1.5	– 1.2
Industrials				
All	69.6	69.2	– 4.3	– 7.6
Nfa†	68.2	68.3	– 4.7	+ 0.3
Metals	70.8	70.0	– 4.0	–13.2
Sterling index				
All items	76.9	77.1	– 3.3	+ 3.0
Euro index				
All items	106.6	106.0	– 1.8	+ 6.7
Yen index				
All items	91.0	92.1	+ 1.8	+12.6
Gold				
$ per oz	268.40	267.40	– 0.8	– 5.7
West Texas Intermediate				
$ per barrel	26.32	27.26	– 7.7	– 8.1

* Provisional. † Non-food agriculturals.

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Stockmarkets

Jul 12th 2001
From The Economist print edition

Market indices

	Jul 11th	2001 high	2001 low	% change on one week	% change on record high	% change on Dec 31st 2000 in local currency	% change on Dec 31st 2000 in $ terms
Australia (All Ordinaries)	3,323.9	3,425.2	3,094.3	– 1.4	– 3.0	+ 5.4	– 4.0
Austria (ATX)	1,212.7	1,244.9	1,052.2	+ 0.5	–30.2	+13.0	+ 3.6
Belgium (Bel 20)	2,870.8	3,030.4	2,591.6	– 0.4	–22.0	– 5.1	–12.9
Britain (FTSE 100)	5,391.9	6,334.5	5,314.8	– 3.7	–22.2	–13.3	–18.0
Canada (Toronto Composite)	7,570.8	9,348.4	7,415.5	– 2.1	–33.5	–15.3	–16.7
Denmark (KBX)	261.1**	294.3	234.7	– 0.7	–13.5	– 1.4	– 9.3
France (SBF 250)	3,169.5	3,820.2	3,107.9	– 4.4	–27.8	–16.0	–22.9
(CAC 40)	4,914.7	5,998.5	4,824.8	– 5.0	–29.0	–17.1	–23.9
Germany (Xetra DAX)	5,801.8	6,795.1	5,388.0	– 3.6	–28.1	– 9.8	–17.3
Italy (BCI)	1,598.9	1,948.4	1,598.9	– 3.2	–26.7	–16.6	–23.5
Japan (Nikkei 225)	12,005.1	14,529.4	11,819.7	– 4.9	–69.2	–12.9	–19.9
(Topix)	1,227.6	1,441.0	1,162.0	– 3.9	–57.4	– 4.4	–12.1
Netherlands (AEX)	551.3	642.3	518.3	– 4.2	–21.4	–13.5	–20.7
Spain (Madrid SE)	807.6	963.9	807.6	– 6.7	–29.5	– 8.3	–15.9
Sweden (Affarsvarlden Gen)	222.8	292.7	217.2	– 5.7	–44.3	–19.7	–29.8
Switzerland (Swiss Market)	6,808.8	8,135.4	6,574.0	– 5.1	–19.1	–16.3	–23.0
United States (DJIA)	10,241.0	11,337.9	9,389.5	– 3.1	–12.6	– 5.1	– 5.1
(S&P 500)	1,180.2	1,373.7	1,103.3	– 4.4	–22.7	–10.6	–10.6
(Nasdaq Comp)	1,972.0	2,859.2	1,638.8	– 7.9	–60.9	–20.2	–20.2
Europe (FTSE Eurotop 300) *	1,317.3	1,545.5	1,279.0	– 5.1	–22.7	–14.1	–21.2
Euro area (FTSE Ebloc 100) *	1,171.6	1,404.1	1,143.9	– 5.2	–24.4	–15.8	–22.8
World (MSCI) †	1,045.7	1,249.2	1,014.6	– 3.7	–27.8	na	–14.4
World bond market (Salomon) ‡	428.4	447.8	420.6	+ 1.0	– 6.9	na	– 3.5

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms. ‡Salomon Smith Barney World Government Bond Index, total return, in dollar terms. **New index.

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About sponsorship

Trade, exchange rates and budgets

Jul 12th 2001
From The Economist print edition

GDP	Trade balance*, $bn latest 12 months	Current account $bn latest 12 mths	Current account The Economist poll % of GDP, forecast 2001	Current account The Economist poll % of GDP, forecast 2002	Exchange rate trade-weighted† Jul 11th	Exchange rate trade-weighted† year ago	Currency units per $ Jul 11th	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of 2001‡
Australia	− 1.4 May	− 12.9 Q1	− 3.0	− 3.0	72.0	77.3	1.97	1.69	2.79	1.70	1.59	0.1
Austria	− 5.5 Mar	− 4.5 Apr	− 2.2	− 2.0	99.9	100.1	16.0	14.6	22.6	13.8	12.9	-0.6
Belgium	+ 12.5 Apr	+ 11.6 Dec	+ 4.2	+ 4.5	98.3	99.0	46.8	42.7	66.2	40.3	37.7	0.7
Britain	− 44.2 Apr	− 19.2 Q1	− 2.1	− 2.4	107.1	105.6	0.71	0.66	–	0.61	0.57	1.2
Canada	+ 45.8 Apr	+ 22.2 Q1	+ 3.3	+ 2.6	79.0	80.1	1.53	1.48	2.16	1.32	1.23	2.6
Denmark	+ 6.1 Apr	+ 3.9 Apr	+ 1.6	+ 1.7	101.6	100.8	8.64	7.90	12.2	7.44	6.96	2.9
France	+ 0.5 Apr	+ 21.3 Apr	+ 1.7	+ 1.8	100.9	101.8	7.62	6.95	10.8	6.56	6.13	-0.5
Germany	+ 57.4 May	− 17.4 May	− 0.8	− 0.6	97.8	98.5	2.27	2.07	3.21	1.96	1.83	-1.7
Italy	+ 2.2 Apr	− 5.9 Mar	− 0.3	− 0.1	72.0	72.6	2,248	2,051	3,179	1,936	1,810	-1.3
Japan	+ 95.6 May	+102.3 May	+ 2.2	+ 2.0	137.7	151.3	124	108	176	107	–	-6.3
Netherlands	+ 17.3 Apr	+ 16.0 Q1	+ 4.1	+ 4.0	97.2	97.9	2.56	2.33	3.62	2.20	2.06	1.3
Spain	− 38.9 Apr	− 16.7 Mar	− 2.8	− 2.7	73.8	74.2	193	176	273	166	156	nil
Sweden	+ 12.9 May	+ 5.5 Apr	+ 2.1	+ 2.3	74.4	83.9	10.80	8.86	15.3	9.31	8.70	3.6
Switzerland	− 0.1 May	+ 31.1 Q4	+11.5	+11.5	107.9	106.1	1.76	1.64	2.49	1.52	1.42	na
United States	−458.2 Apr	−449.3 Q1	− 4.1	− 3.9	120.7	110.3	–	–	1.41	0.86	0.81	2.1
Euro area	− 6.8 Apr	− 30.0 Apr	− 0.3	− 0.1	77.2	79.8	1.16	1.06	1.64	–	0.93	-0.6
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 13.5 Apr	+ 9.5 Apr	na	na	77.7	77.1	6.91	6.30	9.77	5.95	5.56	5.3
Greece	− 7.5 Jan	− 7.7 Jan	na	na	57.1	58.1	396	357	560	341	319	nil
Iceland	− 0.4 Apr	− 0.9 Q4	na	na	na	na	103	78.3	146	88.7	82.9	2.4
Ireland	+ 27.6 Mar	− 0.7 Q4	na	na	86.2	87.6	0.92	0.83	1.30	0.79	0.74	4.5
Luxembourg	− 2.4 Mar	+ 1.2 Q1	na	na	98.3	99.0	46.9	42.7	66.3	40.4	37.8	3.6
New Zealand	− 0.1 May	− 2.3 Q1	na	na	78.5	81.1	2.41	2.17	3.41	2.08	1.94	1.0
Norway	+ 28.1 May	+ 25.6 Apr	na	na	95.4	92.6	9.19	8.63	13.0	7.91	7.40	15.3
Portugal	− 10.9 Mar	− 9.9 Apr	na	na	88.9	89.2	233	212	330	201	188	-1.2

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †1990=100, Bank of England. ‡OECD estimate.

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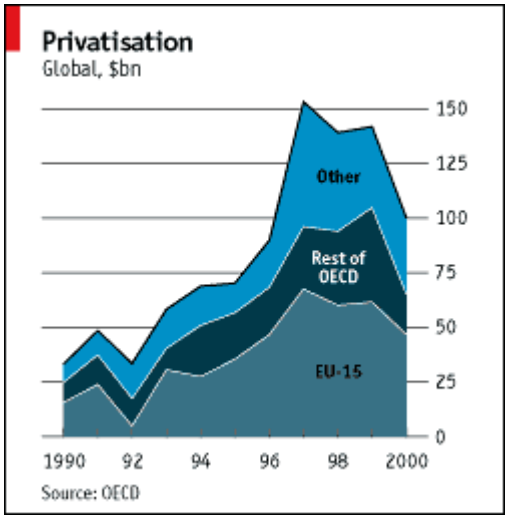
Privatisation

Jul 12th 2001
From The Economist print edition

Total world privatisation proceeds fell to around $100 billion in 2000, down almost a third from 1999. This reflected both falling equity values and maturing privatisation programmes in most OECD countries.



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Output, demand and jobs

Jul 12th 2001
From The Economist print edition

% change at annual rate

	GDP		The Economist poll GDP forecasts		Industrial production	Retail sales (volume)	Unemployment % rate	
	1 qtr	1 year	2001	2002	1 year	1 year	latest	year ago
Australia	+ 4.3	+ 2.1 Q1	+ 2.3	+ 3.8	+ 3.1 Q4*	+ 3.0 Q1	6.9 Jun	6.3
Austria	+ 1.7	+ 2.6 Q4	+ 2.0	+ 2.3	+ 2.5 Apr	+ 2.6 Mar	3.7 May	3.7
Belgium	+ 1.8	+ 2.4 Q1	+ 2.3	+ 2.6	− 2.9 May*	− 1.7 Apr	9.9 Jun*	10.1
Britain	+ 1.7	+ 2.7 Q1	+ 2.2	+ 2.8	− 0.8 Apr	+ 6.4 May	5.0 Apr‡	5.7
Canada	+ 2.5	+ 2.6 Q1†	+ 2.3	+ 3.1	+ 1.0 Apr	+ 3.0 Mar	7.0 Jun	6.6
Denmark	− 4.6	+ 1.0 Q1	+ 1.5	+ 2.1	+ 1.7 Apr	+ 0.2 Apr	5.2 May	5.4
France	+ 2.0	+ 2.7 Q1	+ 2.2	+ 2.5	+ 1.9 Apr	− 2.5 May	8.7 May	9.6
Germany	+ 1.5	+ 1.6 Q1	+ 1.3	+ 2.1	− 1.8 May	− 2.3 May	9.3 Jun	9.6
Italy	+ 2.8	+ 2.4 Q1	+ 2.0	+ 2.3	+ 2.6 Apr	− 0.8 Apr	9.6 Apr	10.7
Japan	− 0.8	− 0.1 Q1	− 0.3	+ 0.9	− 3.9 May	+ 0.1 Apr	4.9 May	4.6
Netherlands	+ 0.2	+ 2.0 Q1	+ 2.2	+ 2.9	− 2.0 May	+ 1.5 Mar	1.9 May§	2.8
Spain	+ 4.1	+ 3.3 Q1	+ 2.7	+ 2.9	− 0.4 May	na	12.9 May	14.3
Sweden	+ 2.4	+ 2.3 Q1	+ 2.3	+ 2.8	− 1.4 Apr	+ 2.3 Apr	3.5 May*	4.1
Switzerland	+ 7.4	+ 2.5 Q1	+ 1.8	+ 2.1	+ 5.1 Q1*	+ 2.2 Mar	1.6 Jun*	1.8
United States	+ 1.2	+ 2.5 Q1	+ 1.6	+ 2.9	− 2.8 May	+ 2.5 Apr	4.5 Jun	4.0
Euro area	+ 2.0	+ 2.5 Q1	+ 1.9	+ 2.4	+ 1.6 Apr	+ 1.5 Apr	8.3 May	8.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Finland	− 0.4	+ 3.4 Q1	na	na	− 2.3 May	+ 6.9 Mar	11.3 May*	11.9
Greece	na	+ 2.5 2000	na	na	+ 8.5 Feb*	+ 5.1 Mar	na	na
Iceland	na	+ 3.6 2000	na	na	+ 2.5 2000	na	1.5 Apr	1.5
Ireland	na	+11.0 Q3	na	na	+17.0 Apr*	+ 1.6 Mar	3.7 Jun	4.1
Luxembourg	na	+ 8.5 2000	na	na	+ 8.6 Mar*†	+ 6.7 Mar	2.4 May	2.7
New Zealand	+ 0.9	+ 0.4 Q1	na	na	+ 0.9 Q1*	+ 1.7 Q1	5.4 Q1	6.4
Norway	+ 0.9	+ 0.3 Q1	na	na	+ 1.1 Apr	− 1.0 Apr	3.7 Q1	3.9
Portugal	+ 2.2	+ 3.4 Q4	na	na	+ 3.4 May*	+ 5.3 Mar	4.2 Q1	4.4

*Not seasonally adjusted. †New series. ‡Feb-Apr; claimant count rate 3.2% in May. §Mar-May

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Overview

Jul 12th 2001
From The Economist print edition

America's unemployment rate rose to 4.5% in June. Almost all the fall in employment was in manufacturing. There was more encouraging news for the rest of the economy: the National Association of Purchasing Manufacturers' index of non-manufacturing activity rose from 46.6 in May to 52.1 in June. A number below 50 is a sign of contraction; one above 50 suggests expansion. The Nasdaq Composite index fell by 7.9%, dropping below 2,000 for the first time in three weeks.

The news from **Germany** was somewhat better than expected, although the outlook remains grim. Industrial production rose by 0.9% in May after dropping by 1.4% in April. Retail sales fell by 2.3% in the year to May, a smaller decline than had been forecast. Exports, too, were not hurt as much as expected by the global slowdown. Even so, export growth tumbled to 4.8% in the year to May from 16.7% in April.

European stockmarkets fell sharply, on renewed worries about technology shares. The Spanish market was also hit by concerns about Latin America.

In **Japan**, the trade surplus shrank to $95.6 billion in the year to May, almost a quarter below the level a year earlier. The 12-month rate of growth of M1 rose to 8.1% in June, the fastest for a year. Broad money grew by 3.2% in June, the fastest rate of expansion since October 1999.

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Prices and wages

Jul 12th 2001
From The Economist print edition

% change at annual rate

	Consumer prices* 1 year		Consumer prices* year ago	The Economist poll consumer prices forecast 2001	2002	Producer prices* 1 year		Producer prices* year ago	Wages/earnings 1 year		Wages/earnings year ago
Australia	+ 6.0	Q1	+ 2.8	+ 4.0	+ 2.4	+ 5.2	Q1	+ 5.6	+ 5.6	Q1	+ 2.9
Austria	+ 3.4	May	+ 1.8	+ 2.3	+ 1.7	+ 2.9	Jun	+ 3.8	+ 2.7	May	+ 1.9
Belgium	+ 2.9	Jun	+ 2.8	+ 2.4	+ 1.9	+ 5.3	May	+ 8.6	+ 1.9	Q1	+ 3.3
Britain	+ 2.1	May	+ 3.1	+ 2.1	+ 2.4	+ 0.4	Jun	+ 2.8	+ 5.2	Apr	+ 5.1
Canada	+ 3.9	May	+ 2.4	+ 2.8	+ 2.1	+ 2.7	May	+ 5.9	+ 0.9	Apr	+ 3.1
Denmark	+ 2.3	Jun	+ 3.3	+ 2.4	+ 2.2	+ 2.9	May	+ 6.4	+ 3.8	Q1	+ 3.6
France	+ 2.1	Jun	+ 1.7	+ 1.8	+ 1.5	+ 2.8	May	+ 5.8	+ 4.3	Q1	+ 5.2
Germany	+ 3.1	Jun	+ 1.9	+ 2.7	+ 1.7	+ 4.0	May	+ 4.9	+ 1.4	Apr*	+ 2.3
Italy	+ 3.0	Jun	+ 2.7	+ 2.7	+ 2.1	+ 2.9	May	+ 6.4	+ 2.7	May*	+ 2.3
Japan	− 0.5	May	− 0.7	− 0.4	− 0.3	+ 0.8	Jun	− 0.6	nil	May	+ 2.1
Netherlands	+ 4.5	Jun	+ 2.7	+ 4.6	+ 2.7	+ 4.4	May	+ 8.2	+ 3.9	May	+ 3.3
Spain	+ 4.2	May	+ 3.2	+ 3.7	+ 2.8	+ 2.7	May	+ 5.8	+ 2.2	Q4	+ 2.4
Sweden	+ 2.9	Jun	+ 1.2	+ 2.2	+ 1.8	+ 2.6	May	+ 3.7	+ 1.8	Apr*	+ 4.1
Switzerland	+ 1.6	Jun	+ 1.8	+ 1.3	+ 1.3	+ 0.4	May	+ 3.0	+ 1.3	2000	+ 0.3
United States	+ 3.6	May	+ 3.2	+ 3.2	+ 2.3	+ 3.8	May	+ 3.7	+ 4.2	Jun	+ 3.7
Euro area	+ 3.4	May	+ 1.9	+ 2.7	+ 1.9	+ 3.6	May	+ 5.3	+ 2.6	Q1	+ 2.4
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 3.4	May	+ 2.9	na	na	+ 3.0	May	+ 8.6	+ 5.0	Q1*	+ 3.5
Greece	+ 3.9	Jun	+ 2.5	na	na	+ 5.1	Apr	+ 7.0	na		na
Iceland	+ 6.8	Jun	+ 5.5	na	na	+ 5.9	Jun	+ 3.9	+ 8.0	May	+ 7.1
Ireland	+ 5.4	May	+ 5.2	na	na	+ 2.4	May	+ 5.9	+ 6.4	Q4*	+ 7.3
Luxembourg	+ 3.3	May	+ 2.5	na	na	+ 2.5	Apr	+ 5.5	+ 7.2	Mar*	+ 4.2
New Zealand	+ 3.1	Q1	+ 1.5	na	na	+ 7.8	Q1	+ 4.9	+ 1.8	Q1	+ 1.4
Norway	+ 3.8	Jun	+ 3.3	na	na	+ 3.5	Jun	+ 8.3	+ 4.4	Q1*	+ 4.1
Portugal	+ 4.8	May	+ 2.6	na	na	+ 5.6	May	+14.9	+ 2.4	Apr*	na

*Not seasonally adjusted.

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Portfolio poll

Jul 12th 2001
From The Economist print edition

We have changed the format of our quarterly portfolio poll, so the table lacks comparative figures for the euro area and the rest of Europe. Otherwise this poll is similar to the most recent exercises—and so is the gloomy state of the world economy. With the spectre of world recession looming, investment managers remain prudent. Credit Suisse and Lehman have considerably reduced their holdings of equities; only Commerzbank greatly raised its equity allocation. There are few economic signals that inspire confidence, and growth is stalling around the globe. Despite this, our fund managers' view of American shares was surprisingly upbeat; all except Credit Suisse raised their holdings this quarter. However, all our managers cut their preferred holdings of euro-zone bonds.

Portfolio poll
2nd quarter 2001

▼▲ A change of 5% points or more on last quarter ▼▲ A change of less than 5% points on last quarter

	Holdings by instrument, %			Equity holdings by area, %							Bond holdings by currency, %				
	Equities	Bonds	Cash	United States	Other Americas	Britain	Euro area	Other Europe	Japan	Other Asia	Dollar	Yen	Sterling	Euro-zone	Others
Robeco Group	53	47 ▼	0 ▲	57 ▲	2	10	15	4	9	3 ▼	36 ▲	19 ▲	11 ▲	31 ▼	3 ▲
Julius Baer PB	54	41	5†	65 ▲	0	4	14	5	8	4 ▼	78	0	0	11 ▼	11 ▲
Commerz Int. CM	59 ▲	41 ▼	0	57 ▲	2	11 ▲	15	2	11 ▲	2	31 ▼	24 ▼	8 ▲	28 ▼	9 ▲
Credit Suisse PB	34 ▼	46 ▲	20‡ ▲	47 ▼	0	11 ▲	25	3	14	0 ▼	89 ▲	0	0	11 ▼	0
Lehman Brothers	60 ▼	35 ▲	5 ▲	49 ▲	0 ▼	9	19	5	13	5	49 ▼	22 ▲	3 ▼	24 ▼	2
Standard Life	62 ▲	38 ▼	0	55 ▲	1	11	17	4	10	2	26 ▼	30 ▲	5 ▲	39 ▼	0
Daiwa	54 ▼	40	6 ▲	48 ▲	2 ▲	9	21	2	15 ▼	3	42 ▲	16 ▼	5	31 ▼	6
Average	54 ▼	41 ▼	5 ▲	54 ▲	1	9	18	4	11 ▼	3 ▼	50	16 ▲	5 ▲	25 ▼	4 ▲
Neutral*				53 ▲	2 ▼	10	17	5	11	2	26 ▼	28 ▲	5	35 ▼	6

*Morgan Stanley Capital International (developed) world equity index; Salomon Brothers world government-bond index
†Of which 3% invested in non-traditional funds ‡Of which 11% invested in alternative investments

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Overview

Jul 12th 2001
From The Economist print edition

A nail-biting week for emerging markets. As fears mounted that **Argentina** might default on its $128 billion debt, lenders demanded higher interest rates not only from Argentina, but from all emerging economies. Argentine shares plunged by 12% to a three-year low. Share prices fell by 21% in **Turkey**, another troubled debtor. Several currencies fell to record lows, including the Brazilian *real,* the Chilean peso and the Venezuelan peso; so did the Turkish lira, the Polish zloty and the South African rand.

The 12-month rate of growth in Brazil's industrial production slowed to 4.2% in May, well below its level in March. But that is still brisk when compared with several East Asian economies. New figures have confirmed that **Singapore** is in recession. Its GDP fell at an annual rate of 10.1% in the second quarter, after a decline of 11.3% in the first quarter; output was 0.8% lower than a year ago.

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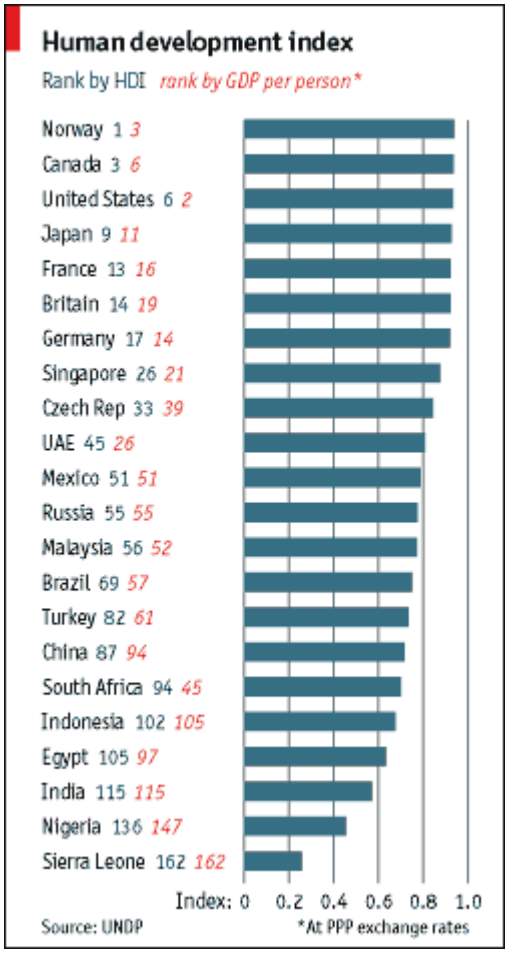
Human development index

Jul 12th 2001
From The Economist print edition

This index produced by the United Nations Development Programme and covering 162 countries, is a broader—and more controversial—measure of well-being than GDP per head. The HDI combines three indicators of welfare: life expectancy, GDP per head and educational attainment . This year, Norway overtook Canada for first place; strife-torn Sierra Leone remains firmly at the bottom.



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Economy

Jul 12th 2001
From The Economist print edition

	% change on year earlier						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 8.1	Q1	+10.2	May	+ 1.7	May	+21.1	May	+20.5	2000	180.2	Apr
Hong Kong	+ 2.5	Q1	− 0.1	Q1	− 1.5	May	−11.9	Apr	+ 8.8	Q1	114.1	Jun
India	+ 5.7	Q3	+ 2.7	Apr	+ 2.5	May	− 5.4	May	− 5.4	Q4	40.1	May
Indonesia	+ 4.0	Q1	+ 4.5	Q4	+12.1	Jun	+25.7	May	+ 5.5	Q3	22.1	Apr
Malaysia	+ 3.2	Q1	− 0.3	Apr	+ 1.6	May	+15.7	May	+ 8.4	Q4	25.6	May
Philippines	+ 2.5	Q1	+12.7	Apr	+ 6.7	Jun	+ 6.7	Apr	+ 9.1	Mar	12.5	Apr
Singapore	− 0.8	Q2	−10.9	May	+ 1.9	May	+ 4.9	May	+21.8	Q1	76.7	Apr
South Korea	+ 3.7	Q1	+ 2.3	May	+ 5.2	Jun	+14.3	Jun	+14.6	May	94.3	Jun
Taiwan	+ 1.1	Q1	− 8.2	May	− 0.2	Jun	+12.2	Jun	+12.0	Q1	110.6	May
Thailand	+ 1.8	Q1	+ 1.6	May	+ 2.3	Jun	+ 2.8	May	+ 6.6	May	31.4	May
Argentina	− 2.1	Q1	+ 0.4	May	+ 0.2	May	+ 1.7	May	− 9.0	Q1	20.2	May
Brazil	+ 4.1	Q1	+ 4.2	May	+ 7.7	May	− 1.6	Jun	+27.1	May	35.5	May
Chile	+ 3.3	Q1	+ 3.2	May	+ 3.6	Jun	+ 1.5	May	− 1.4	Q1	14.4	May
Colombia	+ 1.7	Q1	+ 4.0	Apr	+ 7.9	May	+ 1.6	Apr	− 0.7	Q1	9.7	May
Mexico	+ 1.9	Q1	− 3.2	Apr	+ 6.6	Jun	− 9.7	May	−17.8	Q1	40.6	May
Peru	− 0.9	Apr	+ 2.4	Apr	+ 2.6	May	− 0.3	May	− 1.7	Q4	8.3	May
Venezuela	+ 3.5	Q1	na		+12.5	Jun	+17.2	Dec	+12.5	Q1	10.9	May
Egypt	+ 6.5	2000†	+ 9.4	2000†	+ 2.4	Mar	−10.4	Q4	− 0.8	Q4	12.9	Mar
Israel	+ 1.8	Q1	+ 0.3	Apr	+ 0.7	May	− 7.5	Jun	− 1.4	Q4	23.2	May
South Africa	+ 2.7	Q1	+ 1.7	May	+ 6.4	May	+ 3.8	May	+ 0.1	Q1	6.1	May
Turkey	− 1.9	Q1	−10.5	Apr	+56.1	Jun	−24.6	Apr	− 6.6	Apr	19.9	May
Czech Republic	+ 3.8	Q1	+11.4	Apr	+ 5.5	Jun	− 3.6	May	− 2.7	Q1	12.6	May
Hungary	+ 4.4	Q1	+ 9.4	Apr	+10.5	Jun	− 2.4	May	− 1.8	May	11.0	May
Poland	+ 2.3	Q1	− 1.0	May	+ 6.9	May	−10.2	May	− 9.0	May	26.9	Apr
Russia	+ 4.9	Q1	+ 5.2	Apr	+23.7	Jun	+60.5	Apr	+45.9	Q1	29.8	May
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Pakistan	+ 5.6	2000†	−12.9	Dec	+ 3.9	Apr	− 1.7	May	− 1.4	1999	1.2	Apr
Saudi Arabia	− 0.8	1999	na		− 0.2	Mar	+24.9	1999	+ 0.4	1999	16.9	Mar

*Excluding gold, except Singapore; IMF definition. †Year ending June.

Text refers only to the first 25 countries listed

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Financial markets

Jul 12th 2001
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Jul 11th		Dec 31st 2000	
	Jul 11th	year ago	Jul 11th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	11.7	na	2,259.9	−1.5	+3.1	+3.1
Hong Kong	7.80	7.80	11.0	3.80	12,527.9	−5.1	−17.0	−17.0
India	47.2	44.7	66.7	7.08	3,376.2	+1.9	−15.0	−15.8
Indonesia	11,340	9,400	16,038	17.10	437.4	+2.0	+5.1	−10.4
Malaysia	3.80	3.80	5.37	3.30	618.0	+3.3	−9.1	−9.1
Philippines	53.1	44.8	75.1	10.13	1,390.1	+0.3	−7.0	−12.4
Singapore	1.84	1.74	2.60	2.13	1,661.4	−1.9	−13.8	−18.5
South Korea	1,307	1,116	1,848	5.41	553.7	−7.3	+9.7	+6.2
Taiwan	35.0	30.8	49.4	3.90	4,548.3	−4.0	−4.1	−9.2
Thailand	45.6	40.1	64.4	3.25	312.6	−4.2	+16.1	+10.6
Argentina	1.00	1.00	1.41	16.82	339.4	−12.1	−18.6	−18.7
Brazil	2.54	1.81	3.60	18.32	13,811.8	−1.7	−11.5	−32.1
Chile	666	536	942	3.50**	5,417.8	+0.2	+11.3	−4.2
Colombia	2,311	2,171	3,268	12.75	884.0††	nil	+24.0	+20.0
Mexico	9.28	9.47	13.1	9.42	6,564.1	−4.4	+16.1	+20.3
Peru	3.51	3.48	5.0	11.65	1,318.5	−1.7	+9.1	+9.6
Venezuela	720	685	1,019	12.82	7,453.5	−0.8	+9.7	+6.6
Egypt	3.95	3.48	5.58	9.06	6,073.6	−2.6	−20.7	−21.9
Israel	4.20	4.09	5.94	4.68	415.7	−0.9	−15.9	−19.0
South Africa	8.26	6.83	11.7	9.90	8,882.6	−1.2	+6.7	−2.3
Turkey	1,380,000	624,780	1,951,734	60.00	8,730.0	−21.2	−7.5	−55.1
Czech Republic	39.4	37.6	55.8	5.13	397.2	−3.8	−17.0	−20.8
Hungary	299	276	423	11.30	6,559.3	−1.6	−16.4	−21.1
Poland	4.39	4.29	6.21	16.50	13,076.9	−2.2	−26.7	−31.0
Russia	29.2	27.9	41.3	25.00	196.1†	−8.5	+39.5	+36.9
EMF (MSCI)‡	1.00	1.00	1.41	na	300.9	−6.2	na	−9.9
EMBI+§	1.00	1.00	1.41	na	202.0	−5.1	na	+0.1

**Inflation adj. †In $ terms. ††June 29th. ‡Emerging Markets Free. §J.P. Morgan Chase's Emerging Markets Bond Index Plus.

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